### 2nd ASEAN+3 Bond Market Forum (ABMF) Meeting
12 – 14 December 2010 / Manila, Philippines

<table>
<thead>
<tr>
<th>TIME</th>
<th>PROGRAMME</th>
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<tbody>
<tr>
<td>13 Dec 2010</td>
<td><strong>DAY 1: ABMF Sub-Forum 1</strong></td>
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<tr>
<td>8:30 - 9:00</td>
<td>Registration</td>
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<td>9:00 – 9:10</td>
<td>Welcome remarks by SF1 Chair, Mr. Yutaka Ito</td>
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<td>9:10 – 9:20</td>
<td>Updates by Secretariat (ADB): the work done after the 1st meeting</td>
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#### Part 1: How to construct the SF1 Study: Discussion on the draft questionnaires and Q&A

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<th>Time</th>
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<tr>
<td>9:20 – 9:50</td>
<td>Presentation by Prof. shigeito Inukai, ADB Consultant (Explaining the scope of the study with reference to the draft Japanese market guide)</td>
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<td>9:50 – 10:15</td>
<td>Comments by Mr. Ryuichi Shiina, Japan Securities Dealers Association (JSDA) and Mr. Shuji Yanase, TSE’s Legal Counsel for ABMF - How to collect information: sharing experiences by Japanese members and experts</td>
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<th>Time</th>
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<td>10:15 – 10:30</td>
<td>Coffee Break</td>
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| 10:30 – 11:40 | Detailed explanation of the Draft Questionnaire by ADB Consultant  
Q&A and discussion  
Comments from Mr. Kohei Noda, Ministry of Finance of Japan, to share experience of JGB market developments |
| 11:40 – 12:00 | Report on ABMF- Korea (ABMF-K) by Dr. Suk Hyun, Korea Capital Market Institute  
(Korea established their national preparatory working group for ABMF) |
| 12:00 – 13:30 | Lunch Break                                                                                      |

#### Part 2: Possible Next Steps for ABMF and SF1 after the information collection exercise

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<tr>
<td>13:30 – 14:00</td>
<td>Opening by SF1 Vice Chair, Mr. Lee Kok Kwan</td>
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<td>14:00 – 14:30</td>
<td>Recent bond market developments in the Philippines</td>
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<td>14:30 – 15:00</td>
<td>TOKYO PRO-BOND Market: New bond market for professional investors by Mr Yutaka Ito</td>
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<tr>
<td>15:00 – 15:15</td>
<td>Coffee Break</td>
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**Brainstorming Session**

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<th>Time</th>
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| 15:15 – 16:30 | Next possible agenda items after the information collection exercise  
- Credit Rating  
- Bond Index  
- Asian Funds Passporting  
- Others |
| 16:30 – 16:45 | Closing Remarks by SF1 Chair                                                                       |
Work done after the first meeting and work plan: updates by the Secretariat

Satoru Yamadera, OREI, ADB
2nd ABMF meeting in Manila
the Philippines
13-14 December 2010

The work done and ahead

- First meeting in Tokyo, 28 Sep 2010
  - Teleconferences among the Chairs, Vice Chairs, ADB, and consultants on 15 & 17 Nov.
  - Regular teleconferences among ADB and consultants on Friday
  - Sending draft questionnaires for discussion
- Second meeting in Manila, 13-14 Dec 2010
  - Discussion on the scope of the SF1 & SF2 studies
  - Discussion on possible ABMF agenda items after SF1
  - Revision of the questionnaires based on the discussion at the 2nd meeting
- Third meeting in Kuala Lumpur, 16-17 Feb 2011
  - Agree on the questionnaires
  - Discussion on the recommendation to TF3 on the possible ABMF agenda items
  - Preparation for the ABMF TF3 meeting
- First reporting to TF3 in March
### The work plan (1)

<table>
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<tr>
<th>Month</th>
<th>Activity Details</th>
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| March 2011 | • Reporting to TF3  
          | • Data and information collection based on inputs and guidance by the members and experts |
| April    | Country visits (1) late April  
          | • To collect data and information and to get confirmation from the members and experts, ADB consultant team will visit. |
| May      | Country visits (2) late May  
          | • To collect data and information and to get confirmation from the members and experts, ADB consultant team will visit. |
| June     | Country visits (3)  
          | • To collect data and information and to get confirmation from the members and experts, ADB consultant team will visit.  
          | • Preparation for the fourth ABMF meeting |
| July     | Early July: Fourth ABMF meeting |

### The work plan (2)

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<tr>
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<th>Activity Details</th>
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| July 2011 | Fourth ABMF meeting  
          | • Validation of the study results  
          | • Discussion on how to disseminate the study result  
          | • Preparation of draft report |
| August    | Preparation of draft report |
| Early Sept| Fifth ABMF meeting in Manila  
          | • Approval of the draft report |
| Late Sept or early Oct | Second reporting to TF3 |
| Nov       | ASEAN+3 Deputies |
| Dec       | Report publication |
| Jan 2012  | ABMF 2nd round discussion |
ASEAN+3 Bond Market Forum (ABMF): Sub-Forum 1

Regarding Relationship between the Barriers in the GoE report and the Impediments / Restrictions in the SF-1 Questionnaires

Prof. Shigehito Inukai
Waseda University, Faculty of Law
ADB Consultant - Financial Legal Expert for the Harmonization of Bond Standards in ASEAN+3

Identification of major barriers

Improving information flows in the markets
Timely information, uniform disclosure, price transparency, market statistics, information on corporate actions and legal information such as bankruptcy and insolvency laws.
What barriers were included in the GoE RPT?

- A wide range of factors exist that might be classified as barriers to cross-border bond investment and settlement.
- Various types of barriers were excluded for a number of reasons.
- A number of potential barriers relate to trading and market conditions. These include: market depth and liquidity, trading practices (especially price transparency), current and prospective yields, current outlook for the local currency, the availability of suitable bonds, and the availability of hedging instruments. These may be regarded as ‘trading factors’. It was decided that these factors were out of scope of the present study, which was intended to focus on the post-trade process.
- In this respect, tax is both a trading factor and a post-trade factor. It is a trading factor to the extent that it affects net yields. It is a post-trade factor viewed from the regulatory and procedural aspect. Given its clear importance in the latter respect, it was included. Currency convertibility restrictions and credit controls for foreign investors are similar examples.
- The GOE therefore focused on barriers in the following areas. It was convenient to divide the barriers into two groups. We called these ‘regulatory barriers’ and ‘settlement-related’ barriers:
  - “Regulatory framework” was not included in the GoE questionnaire.

### Regulatory and settlement barriers

- A) Foreign investor quota
- B) Foreign investor registration
- C) FX (Currency exchange) controls – conversion
- D) FX (Currency exchange) controls – repatriation
- E) Cash controls - credit balances
- F) Cash controls - overdrafts
- G) Taxes
- H) Omnibus accounts
- I) Settlement cycle
- J) Messaging formats (standards)
- K) Securities numbering
- L) Trade and settlement matching
- M) Physical certificates (Dematerialisation) – related to legal framework
- N) Regulatory framework
- O) Legal framework

Covered in the GoE Report

Also Covers in the SF-1 Questionnaires
**What aspects of the ASEAN+3 local currency bond markets would you most like to see improved?**

Introductory questions No.25: The responses are summarised in the chart below. The most frequently mentioned issues were FX controls and taxes, followed by differences in legal jurisdiction, investor registration requirements, and different settlement cycles.

![Chart showing frequency of barriers across ASEAN+3 markets](chart.png)

**Frequency of barriers across ASEAN+3 markets in the GoE report**

- A: Quotas
- B: Investor registration
- C: FX controls - conversion
- D: FX controls - repatriation
- E: Cash controls - credit balances
- F: Cash controls - overdrafts
- G: Taxes
- H: Omnibus accounts
- I: Settlement cycle
- J: Message formats
- K: Securities numbering
- L: Matching
- M: Dematerialisation

[Chart showing frequency of barriers across ASEAN+3 markets](chart.png)
Market assessment scoring in the GoE report

- To provide a simple, comprehensive, and objective assessment of each market
- To identify regional barriers
- To support construction of the roadmap for each market by having a common framework of assessment

### Market Assessment Questionnaire scores and barrier thresholds

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<tr>
<th>Potential barrier area</th>
<th>Total number of questions in area</th>
<th>Barrier scores</th>
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### Market barriers based on Market Assessment Questionnaire scores

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**HIGH barriers: 6 0 2 0 1 0 1 0 1 3**

**LOW barriers: 4 2 6 2 4 5 7 3 6 7**

**Total barriers: 10 2 8 2 5 5 8 3 7 10**

**Key:**

- 'High' barrier HI
- 'Low' barrier LO

Note: “Regulatory framework” was not included in the GoE questionnaire.

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### Market barriers Based on overall assessments

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**HIGH barriers: 6 0 4 0 2 0 3 0 2 4**

**LOW barriers: 5 3 5 2 3 2 5 1 7 6**

**Total barriers: 11 2 9 2 5 2 8 1 9 10**

**Key:**

- 'High' barrier HI
- 'Low' barrier LO

Note: “Regulatory framework” was not included in the GoE questionnaire.
Conclusions regarding the barriers in the GoE report

- Regulatory issues - taxes, FX controls and cash controls are of main concern to market participants
  - May not be critical if rules and procedures are clear and easy
  - Most markets are "workable"
  - But need time and effort to understand the rules, and this is a barrier
- Settlement issues such as messaging format and security numbering also remain as barriers to STP in many markets
- Some markets have made rapid progress in removing barriers but it is not so easy to understand them for foreign market participants
- Perception may be different from reality
  - Especially for investors with little recent experience in those markets

Information to be collected

- Collect all relevant information on regulations as well as market structures and practices in the region.
  - In Order to Close the Information Gap within ASEAN+3 Economies
  - In Order to Establish the Common Platform to Foster Standardization of Market Practices and Harmonization of Regulations relating to Cross-border Bond Transactions in the Region
ITEMS for Investigation
Exemplification of the expected items

• Disclosure & Investor Protection Rules
• Credit rating System
• Issuance Procedures (Auction, Primary Dealer System, etc)
• Electronic Trading Platform and Mandatory Trading Requirements
• Trading Rules (Repo, etc.)
• Redemption Procedures
• Requirements for Investors (Registration, Documentation, etc) / QIB / Professional Investor
• Taxation & Tax Procedures (Income and Capital Gain tax, WH-tax, Stamp Duty, etc.)
• Investment Rules for Domestic Investors
• Foreign Investor Quota / Foreign Investor Registration / Currency Exchange Controls
• Cash Controls—Credit Balances / Overdrafts
• Utilization of Omnibus Accounts (Security Account Holding Structure)
• Settlement & Clearing Systems / Custody Systems
• Legal Framework / Governing Law
• Bankruptcy Procedures related to Bond Transaction
• Regulatory Framework / Self-Regulatory Framework / Market Practices
• Role of Investment Exchange / Industrial & Market Association / Dealers Association / Regulators

ITEMS of the SF-1 Questionnaire

Questionnaire 1: High Level Structure, Type & Characteristics of the Bond Market
Questionnaire 2: Primary and secondary market related regulatory frameworks
Questionnaire 3: Trading of Bonds and Trading Market Infrastructure
Questionnaire 4: Possible item of impediments / restrictions for the realization of a cross-border inter-regional market (Need to refer Each Economy’s Market barriers Based on overall assessments in the GoE report)
Questionnaire 5: High level description of the securities settlement system
Questionnaire 6: Costs and charging methods
Questionnaire 7: Market size / statistics
Expectation

• Based on the GOE final report: “Summary of barriers in each market” which clearly describes barriers in each market, participants are expected to include these barriers items in the answer to the Questionnaire 4: Possible item of impediments / restrictions for the realization of a cross-border inter-regional market.
The Questionnaire for the 2\textsuperscript{nd} ABMF\textsuperscript{-} Sub Forum1
on 13 December 2010 in Manila

The Survey for the Debt Capital Market Structures, Regulations and Practices

Introduction:

1. ABMF SF-1 will collect relevant regulatory information, market practices, and market structures. The scope of the study will be much wider than the GoE report as the report does not include regulations related to investors and issuers.

2. This questionnaire was produced to be used for the data collection exercise in each economy in the region.

3. The objective of this work will be
   a. To Close the Information Gap within ASEAN+3 Economies, and
   b. To Establish the Common Platform to Foster Standardization of Market Practices and Harmonization of Regulations relating to Cross-border Bond Transactions in the Region.

4. The scope of data collection and the template of the questionnaire must be agreed among the national members and experts before collecting the information.

5. The points to be regarded as important will be as follows:
   a. The information collection exercise needs to consider national differences.
   b. Positive engagement between the private sector and regulator will be important, and ABMF should be taken as endorsement for such engagement in each market in the region.
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ITEMS for the survey: Exemplification of the expected items

(The following items are just for the reference)

- Disclosure & Investor Protection Rules & Regulations
- Credit rating System
- Issuance Procedures (Auction, Primary Dealer System, etc)
- Electronic Trading Platform and Mandatory Trading Requirements
- Trading Rules (Repo, etc.)
- Redemption Procedures
- Requirements for Investors (Registration, Documentation, etc) / QIB / Professional Investor
- Investment Rules for Domestic Investors
- Taxation & Tax Procedures (Income and Capital Gain tax, WH-tax, Stamp Duty, etc.)
- Foreign Investor Quota / Foreign Investor Registration / Currency Exchange Controls
- Cash Controls—Credit Balances / Overdrafts
- Utilization of Omnibus Accounts (Security Account Holding Structure)
- Settlement & Clearing Systems / Custody Systems
- Legal Framework / Governing Law
- Bankruptcy Procedures related to Bond Transaction
- Regulatory Framework / Self-Regulatory Framework / Market Practices
- Role of Investment Exchange / Industrial & Market Association / Dealers Association / Regulators
Questionnaire 1: High Level Structure, Type & Characteristics of the Bond Market

- **Breakdown or Segmentation of the Market**
  (The following items are just for the reference)
  - For Instance, By Market Type, Government Bond, Public Bond, Other Bonds / Corporate Bond
  - By Market Category, Public Offering Market / Private Placement Market
  - Exchange Listed Market / Non listed Market
  - Securitized Products / Covered Bonds
  - Professional (wholesale) market / Retail Market
  - Mutual relations of above markets type / category
  - Definition of Professionals / Professional Investors

- Methods of Issuing Bonds
- Credit Rating System (CRS)
- Bond Related Systems for Investor Protections (Trustee System, etc)
- Listing of Bonds &MTNs
- Governing Laws of Bond issuance
- Related Legal and Regulatory issues behind the Market
- Self-Governing Rules behind the Market
- Bankruptcy Procedures

*Examples of other points of consideration*

- Degree of Opening of Domestic Bond Markets to Foreign Investors
- Degree of Opening of Domestic Bond Markets to Foreign Issuers
- Degree of Segregation / Relation between Domestic Market and Inter-Regional (Eurobond) Market
Questionnaire 2: Primary and secondary market related regulatory frameworks

(The following items are just for the reference)

- **Issuing debt instruments (Issuer’s regulation / rule) (Primary Market related)**
  (The following items are just for the reference)
  ✓ Disclosure requirements (filing, prospectus, etc.)
  ✓ Credit rating requirements
  ✓ Exemptions for private issues
  ✓ Exemptions for specific instrument type, e.g. MTN
  ✓ Minimum lead time (number of business days) for registration approval
  ✓ Availability of shelf registration and associated documentation requirements
  ✓ Regulated suspension period (this may relates to investor protection)
  ✓ Other requirements (Including currency denominations)

- **Buying debt instruments (Investor’s regulation / rule) / (Secondary Market related)**
  (The following items are just for the reference)
  ✓ Continuous disclosure rules or requirements
  ✓ Restrictions for investors (investment grade, etc.)
  ✓ Definition of Qualified Institutional Investors, Professional Investors, if exist
  ✓ Non-resident requirements / restrictions
  ✓ How to ensure market functions for the finding of Fair Price

- **Taxation Framework and Tax requirements**
  (The following items are just for the reference)
  ✓ Withholding tax for CP, Bonds and other instruments (wholesale, retail)
  ✓ Tax reporting requirements for issuer / paying agent
  ✓ Tax exemption requirements for non-residents

- **Regulatory reporting requirements**
  ✓ Reporting requirements in case of direct deal between issuers and investors
  ✓ Reporting requirements in case of cross boarder deal
  ✓ Reporting requirements in the Foreign Currency denominated instruments

- **Challenges / Expected changes**
  ✓ Issues on current regulations / rules
  ✓ Expected regulatory reforms
Questionnaire 3: Trading of Bonds and Trading Market Infrastructure

(The following items are just for the reference)

- **Trading of Bonds**
  - ✓ *OTC Trading of Bonds*
  - ✓ *Bond Repurchase Market*
  - ✓ *PTS / Trading Systems*
  - ✓ *Secondary Market Yields and Terms of Bond Issues*
  - ✓ *Transparency in Bond Pricing*
Questionnaire 4: Possible item of impediments / restrictions for the realization of a cross-border inter-regional market

(The following items are just for the reference)

- Possible Item of Impediments / Restrictions
  - Taxation (Withholding Tax on Interest Income, Stamp Duty, Tax Report Requirement, etc.)
  - Disclosure & Investor Protection Rules for Issuers
  - Underwriting Rules for Financial institutions
  - Impediments for Timely issuance (suspension period, disclosure requirements, etc.)
  - Restriction of Investors (qualified institutional investors, private placement)
  - Registration Requirement for Foreign Investors
  - Reporting requirements (non-resident trade report, foreign currency denominated instruments etc.)
  - Non-resident requirements (identification requirement, restricted stocks, etc.)
  - Restrictions on OTC Transactions by Residents
  - Restrictions on OTC Transactions by Non-residents
  - Credit Rating System and its relation to Regulations
  - Utilization of Shelf Registration System / MTN
  - Prohibition on the Use of Omnibus Accounts for Settlement of Securities Transactions
  - Availability of Information in English
  - Restrictions in Accounting Standard
  - Limited Opportunities to Utilize Bond Holdings / Repo Market
  - Degree of Lack of Liquidity in the Secondary Market
  - Others
Questionnaire 5: High level description of the securities settlement system

(The following items are just for the reference)

- **Legal definition of debt instruments**
  - Existence of uniform legal framework for (all / certain) types of securities
  - Dematerialization / Immobilization vs. Physical securities
  - Legal ownership structure of dematerialized / immobilized securities
  - Legal ownership transfer mechanism

- **Securities settlement infrastructure**
  - Existence of CSD and Book entry system for debt instruments
  - Existence of DVP and RTGS mechanism
  - Existence of post-trade matching mechanism
  - Existence of execution matching mechanism
  - Settlement scheme (Gross-Gross, Gross-Net, Net-Net) for Corporate Bond, Government Bond and other debt securities
  - Settlement cycle for Corporate Bond, Government Bond and other debt securities
  - Brief history of the development of the Securities settlement infrastructure

- **Challenges / Expected changes**
  - Issues on current settlement infrastructures
  - Expected changes on settlement infrastructures
Questionnaire 6: Costs and charging methods

(The following items are just for the reference)

- **Average issuing costs for Corporate Bonds and CPs**
  - Registration fee at CSD
  - Transfer fee (CSD, Bank)
  - Underwriting fee
  - Fiscal Agent fee
  - Other fees

- **Average on-going costs for Corporate Bonds and CPs**
  - Maintenance fee at CSD
  - Interest payment / redemption fee at CSD
  - Interest payment / redemption fee at Paying Agent
  - Brokers commission (if applicable)
  - Other fees
Questionnaire 7: Market size / statistics

(Items and Format will be discussed later)

- **Market size from the following point of view (by Local Currency)**
  - Outstanding amount end of the year and yearly issuing amount
  - Capital market (Direct financing) vs. Bank loans (Indirect financing)
  - Capital Market instruments and their outstanding amount
  - Domestic financing vs. International financing
  - Public placement vs. Private placement
  - Primary market vs. Secondary market (with rollover volume)

- **Main players in the market**
  - Type of issuers (domestic vs. international, financial vs. non-financial)
  - Type of investors (banks, institutional investors, etc.)
  - Underwriters (banks, investment bankers, etc.)
  - Fiscal Agents (banks, custodians, etc.)
  - Other participants

- **History of Debt Market development**
  - Historical growth by instrument type
  - Major events which trigger the market growth
Questionnaire 8: Islamic Finance

- **Significance of Islamic bonds (Sukuk)**
  - Issue size and transaction volume relative to the conventional market

- **Regulatory framework for Islamic Finance**
  - Specific regulation(s) in comparison to the conventional finance
  - Specific Supervision in comparison to the conventional finance
  - Related Tax issues (Withholding Tax, Stamp duty and/or other taxes: Double taxation measures of real estate transactions, Tax relief for dividends (tax exemption))

- **Others**
Questionnaire 9: Next Step → Future Direction

(Please describe freely)
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Debt Capital Market Structures, Regulations and Practices

Economy: Japan

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- Investment Rules for Domestic Investors
- Taxation & Tax Procedures (Income and Capital Gain tax, WH-tax, Stamp Duty, etc.)
- Foreign Investor Quota / Foreign Investor Registration / Currency Exchange Controls
- Cash Controls—Credit Balances / Overdrafts
- Utilization of Omnibus Accounts (Security Account Holding Structure)
- Settlement & Clearing Systems / Custody Systems
- Legal Framework / Governing Law
- Bankruptcy Procedures related to Bond Transaction
- Regulatory Framework / Self-Regulatory Framework / Market Practices
- Role of Investment Exchange / Industrial & Market Association / Dealers Association / Regulators
Examples of the recommended Expression (RE) of the Related Translations
(This part has not been finalized yet)

a. Laws and ordinances

i. (RE) Act on Special Measures Concerning Taxation (Japanese law translation by Ministry of Justice)
   = 租税特別措置法 (sozei tokubetsu sochihou)
   (AE) Special Taxation Measures Law

ii. (RE) Companies Act (Japanese law translation by Ministry of Justice)
    = 会社法 (kaishahou)
    (AE) Company Law
    (AE) Corporations Act
    (AE) Corporations Law

iii. (RE) Financial Instruments and Exchange Act 【Abbreviation: FIEA】
     (Japanese law translation by Ministry of Justice)
     = 金融商品取引法 (kinyuu shouhin torihikihou)
     (AE) Financial Instruments and Exchange Law 【Abbreviation: FIEL】

iv. (RE) Order for Enforcement
    = 施行令 (sekourei)
    Reference: Cabinet Order = 政令 (seirei)
    Cabinet Office Ordinances = 内閣府令 (naikakufurei)
    The Order for Enforcement of the Financial Instruments and Exchange Act = 金融商品取引法施行令

v. (RE) Cabinet Office Ordinance on Disclosure of [Corporate Information, etc. /Information, etc. on Issuers of Foreign Government Bonds, etc./Information, etc. on Specified Securities]
   = 企業内容/外国債/特定有価証券]開示府令 (kaiji furei)
   (From the Name of Laws and Regulations, FSA Japan
   http://www.fsa.go.jp/frtc/kenkyu/event/20070424_01.pdf)
vi. (RE) Cabinet Office Ordinance on Definitions under Article 2 of the Financial Instruments and Exchange Act
= 定義府令 (teigi furei)

vii. (RE) Cabinet Office Ordinance on Securities Information
= 証券情報の提供又は公表に関する内閣府令 (naikakufurei)

viii. (RE) Cabinet Office Ordinance on Financial Instruments Business, etc.
= 業府令 (gyoufurei)

ix. (RE) Law Concerning Book-Entry Transfer of Corporate Bonds, Stocks, and Other Securities = 社債、株式等の振替に関する法律 (shasai kabusiki tou no furikae ni kansuru houritsu)

b. Disclosure Documents

i. (RE) specified securities information
= 特定証券情報 (tokutei shouken jouhou)

ii. (RE) Issuer filing information
= 発行者情報 (hakkoushajouhou)

iii. Securities registration statement (SRS)
= 有価証券届出書 (yuukashouken todokedesho)

iv. (RE) Annual securities report
= 有価証券報告書 (yuukashouken houkokusho)
(AE) securities report

v. (RE) Semiannual securities report
= 半期報告書 (hanki houkokusho)
(AE) semiannual report
vi. (RE) Quarterly securities report
= 四半期報告書 (shihanki houkokusho)
(AE) quarterly report

vii. (RE) Extraordinary report
= 臨時報告書 (rinji houkokusho)
(AE) current report

viii. (RE) Shelf registration statement
= 発行登録書 (hakkoutourokusho)

ix. (RE) Supplement to shelf registration statement (Practical term)
= 発行登録追補書類 (hakkoutouroku tsuishorui)
(AE) shelf registration supplement （Japanese law translation by Ministry of Justice）（FSA's Official translation）

x. (RE) securities notice
= 有価証券通知書 (yuukashouken tsuuchisho)

c. Offering and distribution

i. (RE) public offering【Abbreviation: PO】
= 募集 (boshuu)
（Japanese law translation by Ministry of Justice）（FSA's official translation）

Under the FIEA, an offering which is subject to requirements to disclose the solicitation documents stipulated in the FIEA is called “public offering”, and an offering which is not subject to such requirements is called “private placement.” However, the expression does not always reflect the economic nature of the offering. For example, offering to specified investors is in a strict legal sense “private placement,” but is similar to “public offering” by its true nature. Issuers are required to submit specified securities information in place of securities registration statement (SRS).

ii. (RE) public offering of newly-issued securities
iii. (RE) secondary distribution
= 売出し (uridashi)
（Japanese law translation by Ministry of Justice）（FSA’s Official translation）

Especially in the context that does not need to distinguish between a public offering and a secondary distribution, "public offering" is sufficient for translation.

iv. (RE) Specified Investor
= 特定投資家 (tokutei toushika)
This is the most frequently used expression in the practice of business in Japan.
This expression is used in the FSA’s PR materials.

Alternative expression (AE) 1 = specific investor
This word was used in relatively old PR materials in the FSA.

Alternative expression (AE) 2 = professional investor
（Japanese law translation by Ministry of Justice）（FSA’s official translation）

v. (RE) Private placement for specified investors
= 特定投資家私募 (tokutei toushika shibo)
This word is legally correct because this is a part of the private placements in Japanese Law (FIEA)

vi. (RE) Offer to specified investors 【 Abbreviation: Offer to SI 】
= 特定投資家公募 (tokutei toushika koubo)
This word is a practical translation focusing on the reality that many investors can be subject to the public offering.
vii. (RE) Offer of newly-issued securities to specified investors
= 特定投資家(新発)公募 (tokutei toushika shinpatsu koubo)
If you want to distinguish the primary market offering of the new issue from the private placement of already-issued securities, we will use the above expression.
(AE) Primary offering to specified investors

viii. (RE) Offer to specified investors
= 特定投資家私売出し (tokutei toushika shiuridashi)
(AE) Private placement for specified investors

ix. (RE) Offer of already-issued securities to specified investors
= 特定投資家(既発)公募 (tokutei toushika kihatsu koubo)
(AE) Secondary offering to specified investors
Especially in the context that needs to distinguish between a private placement of newly-issued securities and a offer of already-issued securities, this term is used.

x. (RE) Securities for specified investors
= 特定投資家向け有価証券 (tokutei toushika muke yuukashouken)
This expression is used in the SESC’s PR materials.
(AE) securities intended for specified investors
This expression is used in the FSA’s PR materials.

xi. (RE) Private Placement for qualified institutional investors (QIIs)
【Abbreviation: QII-PP】
= 適格機関投資家私募 (tekikaku kikan toushika shibo)

xii. (RE) Private Placement of newly-issued securities for QIIs
(AE) primary private placement for QIIs

xiii. (RE) Private Placement for QIIs 【Abbreviation: QII-PP】
= 適格機関投資家私売出し (tekikaku kikan toushika shiuridashi)

xiv. (RE) Private Placement of already-issued securities for QIIs
(AE) secondary private placement for QIIs

xv. (RE) Private Placement for small number of people 【Abbreviation: SN-PP】
= 少人数私募 (shouninzuu shibo)

xvi. (RE) Private Placement of newly-issued securities for small number of people
(AE) primary private placement for small number of people

xvii. (RE) Private Placement for small number of people 【Abbreviation: SN-PP】
= 少人数私売出し (shouninzuu shiuridashi)

xviii. (RE) Private Placement of already-issued securities for small number of people
(AE) secondary private placement for small number of people

d. Others

i. (RE) Commissioned Company for bondholders
   (practical and understandable term)
= 社債管理者 (shasaikanrisha)
(AE) bond manager (Japanese law translation by Ministry of Justice)
(AE) bond administrator (This word was used in relatively old materials in the era of the previous commercial code.)

ii. (RE) financial instruments business operator
= 金融商品取引業者 (kinyuushouhin torihiki gyousha)

iii. (RE) registered financial institution
= 登録金融機関 (touroku kinyuukikan)

iv. (RE) financial instruments business operator, etc
= 金融商品取引業者等 (kinyuushouhin torihiki gyousha tou)

v. (RE) Director-General of the Kanto Local Finance Bureau
= 関東財務局長 (kantouzaimukyokuchou)
(AE) Director of the Kanto Local Finance Bureau (old expression)
Questionnaire 1: High Level Structure, Type & Characteristics of the Market

(The following items are just for the reference)

- **Breakdown or Segmentation of the Market**
  (The following items are just for the reference)
  ✓ For Instance, By Market Type, Government Bond, Public Bond, Other Bonds / Corporate Bond
  ✓ By Market Category, Public Offering Market / Private Placement Market
  ✓ Exchange Listed Market / Non listed Market
  ✓ Professional (wholesale) market / Retail Market
  ✓ Mutual relations of above markets type / category
  ✓ Definition of Professionals / Professional Investors

- **Methods of Issuing Bonds**

- **Credit Rating System (CRS)**

- **Bond Related Systems for Investor Protections (Trustee System, etc)**

- **Listing of Bonds &MTNs**

- **Governing Laws of Bond issuance**

- **Related Legal and Regulatory issues behind the Market**

- **Self-Governing Rules behind the Market**

- **Bankruptcy Procedures**

*Examples of other points of consideration*

✓ Degree of Opening of Domestic Bond Markets to Foreign Investors
✓ Degree of Opening of Domestic Bond Markets to Foreign Issuers
  ✓ Degree of Segregation / Relation between Domestic Market and Inter-Regional (Eurobond) Market
§1.01 Types of Bonds

The term “bonds” generally refers to debt securities issued by governments and other public entities as well as by private companies. The issuance of bonds is a means of direct financing, through which the issuer raises funds, but, unlike equity financing, the issuer has an obligation to repay the principal at maturity.

Bonds are classified into the followings.

[2] Local Governments Bonds (prefectures, municipalities (cities, towns and villages)), (地方債).
   (3-1) Japanese Government-guaranteed bond (政府保証債)
   (3-2) FILP*-Agency bond (財投機関債)
      *Use of proceeds are limited to and built into FLIP (Fiscal Loan and Investment Program of Japanese Government approved by Diet).
   (3-3) Government Affiliated Corporation Bonds (非公募特殊債)
[4] Local Public Corporation bonds (地方公社債)
[5] Local Governments Agency bond (JFM** bond) (地方公共団体金融機構債)
   ** Japan Finance Organization for Municipalities founded by all local governments (prefectures, cities, wards, towns and villages).
[6] Corporate bonds (社債)
   (6-1) Straight corporate bonds, etc. (普通社債等)
   (6-2) Asset Backed corporate bonds (資産担保型社債)
   (6-3) Convertible bonds (転換社債),
[7] (Bank debentures (金融債), and
[8] Nonresident bonds (foreign bonds) (非居住者債)
   (8-1) Yen-denominated foreign bonds (円建て外債)(サムライ債)
   (8-2) Asset-backed foreign bonds (資産担保型非居住者債).

(NOTE) Corporate Bonds, Asset backed bonds and Nonresident bonds are subject to disclosure requirements under Financial Instruments and Exchange Act of Japan.
(FIEL). All other bonds are exempt from FIEL disclosure requirement.

Explanation of the Major Types of Bonds:

[1] Government bonds

First, government bonds are those issued by the national government, and they are classified by length of maturity: (1) short-term bills (maturing in one year or less), (2) medium-term notes (maturing in two to five years), (3) long-term bonds (maturing in six to ten years) and (4) super long-term bonds (maturing over ten years)

In fiscal 2002 (ended on March 31, 2003), the government introduced the STRIPS and (variable-rate) retail ten-year Japanese government bond (JGB) programs.

The principal and individual interest payment components of JGBs designated by the Ministry of Finance as “book-entry securities eligible to strip” has been traded as separate zero-coupon government bonds. Ts

Subsequently, the government started issuing (1) ten-year CPI (consumer price index)-linked bonds, (2) five-year bonds for retail investors and (3) forty-year fixed-rate bonds in fiscal 2003, 2005, and 2007, respectively.

[2] Local Governments Bonds (prefectures, municipalities (cities, towns and villages))

Local governments and municipalities borrow funds on deeds from banks or issue debt securities in the market. Sometimes we call them municipal debt.

Those issued in the bond market are generally called “Local Governments Bonds”

Of these, those securities that are placed with the general investing public are called “publicly offered municipal bonds,” while those placed privately with local banks and other financial institutions are called “privately placed municipal bonds.”


Government agency bonds are debt securities issued by various government-affiliated entities, such as incorporated administrative agencies.

Agency bonds are divided into
(3-1) Government-Guaranteed bonds that are backed by the full faith and credit of the government,
(3-2) FILP-Agency bonds, those bonds are issued by treasury investment and loan agencies that do not enjoy such guarantee, and
(3) Government Affiliated Corporation Bonds
The three categories of debt securities mentioned above are sometimes collectively called “public sector bonds.”

[6] Corporate bonds
In addition to nonfinancial enterprises, banks and consumer finance companies may also issue corporate bonds.

[7] Bank Debentures
Bank debentures are debt securities issued by certain banking institutions under special laws and play a fund-raising role as an alternative to deposits.
They are principally issued in the form and maturities of five-year interest-bearing and one-year discount debentures.

[8] Nonresident bonds (Foreign Bonds)
Foreign bonds are defined as debt securities issued in Japan by non-Japanese resident issuers. Those denominated in yen, in particular, are separately classified as yen-denominated foreign bonds, or samurai bonds.
§1.02  Methods of issuing Bonds other than Corporate Bonds

[1] Government bonds

Government Debt Securities (JGB) are issued in either underwritten by primary dealers (so-called participants) and resale to the public market or direct subscription by Bank of Japan (BoJ) and other government affiliated parties.

Major volume of JGB issuance and distribution are sustained by primary dealers, while BoJ underwriting has given comfort on balance of supply-and demand in JGB market.

This section deals with the former two methods of issuance.

[1-1] Public Auctions based on Competitive Bidding

When issued in the market, JGBs are primarily underwritten by participants through auction. The syndicated underwriting was discontinued in fiscal 2006.

Depending on the type of securities to be auctioned, there are two types of auction existing in JGB market: “Conventional Auction Method” and “Dutch Auction Method”.

Under Conventional Auction, a participant is able to post several prices until aggregated bidding amounts reach its lawful limit of bidding amount. A participant will get each allocation at each bid price as long as bid price is tighter than cut-off rate where aggregated participants' bid amounts reach scheduled issue amount of JGB.

Under the Dutch auction, the auction price for the last bond that reaches scheduled total issue amounts will be the issue price for whole issue. A participant will get allocation equal to total bidding amounts that the participant posted tighter than the issue price.

[1-2] Noncompetitive Bidding / Non-price Competitive Auctions

Other than competitive bidding, two-, five-, and ten-year fixed-rate JGBs are also offered through a noncompetitive bidding process that facilitates small and medium-sized bidders and through Non-price Competitive Auctions I and II reserved for special participants (23 companies are designated as of October 2009).

[2] Local Government Bonds (Prefecture bonds and Municipalities (City, Town and
Under local finance law, concept of local government bond exclude less than one year finance, and includes not only bonds but also loans. To avoid complication, hereafter we exclude loans from definition of local government bond.

The Local Autonomy Law authorizes Japanese Local Governments - prefectures, municipalities (cities, towns and villages), Tokyo’s special wards and local government cooperatives borrow money provided that following conditions are fulfilled:

- A local public body must prepare a budget plan that defines the use of proceeds from the proposed bond issue and obtains the approval of the local assembly.
- The actual issuance for prefecture and designated city is also subject to consultation with the Minister of Internal Affairs and Communications (MIC), and for ordinary city, town and village are subject to consultation with the governor of the prefecture concerned (local bond consultation system).
- Use of proceeds is confined to what local finance law determines.

So far, 30 prefectures and 19 designated cities have issued local government bonds through public offerings.

Local Government bonds issuance terms are determined based on negotiations between the issuer and the underwriting syndicate. They take into account a broad range of factors, including trading conditions, spreads over JGBs, and trends in the overall bond market.

There is also Joint Local Government Bonds which are issued in a form of public offering each month by 33 Local Governments under the joint and several guarantees.

[3-1] Government Guaranteed Bonds

The issuance of government-guaranteed bonds is planned as part of the Fiscal Investment and Loan Program (FILP) and annual ceilings on the issue amount must be approved by the Diet.

All government-guaranteed bonds are issued in the form of interest-bearing bonds with maturities ranging from two to thirty years.

The government-guaranteed bonds are issued by way of either (1) negotiated underwriting by a so-called national syndicate or (2) Dutch auction.

In the former method, the terms of issue are determined based on the average of
pre-marketing results of all national syndicate members; in the latter, the terms are set through competitive bidding.

[3-2] FILP-agency bonds

FILP-agency bonds are also issued as interest-bearing bonds and with many maturities in five or ten years. In issuing them, the issuing agency usually selects a lead manager, which, in turn, forms an underwriting syndicate.

----- Ref. P.86-88, [Securities Market in Japan 2010, JSRI]
§1.03 Methods of issuing Corporate Bonds

The issuance of corporate bonds had long been subject to strict regulation. However, the Commercial Code was amended in 1993 to drastically change the system, and the regulations on the issuance of corporate bonds have been substantially eased.

In the case of public offering of corporate bonds, the issuing corporation (issuer) first appoints a lead manager and other underwriters that together constitute an underwriting syndicate, a commissioned company for bondholders (see § 1.09) or a fiscal agent (FA), and providers of other relevant services and at the same time applies for a credit rating.

Under normal circumstances lead manager(s) go ahead with price discovery followed by book building process by all syndicate members.

The issue terms of the bonds are finalized first thing in the morning on the pricing date based upon the book that had been closed prior to the pricing. Then, the subscription starts immediately after final terms and condition are electronically filed with Local Finance Bureau of the Ministry of Finance of Japan.

Subsequently, payment for the bonds is made, and the issuance of the corporate bonds is completed.

As for price talk and pricing more recently, an increasing number of issuers employ “spread pricing,” a method under which the investors’ demand is measured in terms of a spread over JGB yield or over Libor rate. Top tier issuers are priced based upon JGB spread.

Since 2000, a new practice known as “Internet-based bond issue”—a series of new issue procedures covering a price discovery, book building and pricing carried out through the Internet—has been prevailing since mid 90’s.

Discount bank debentures are issued twice a month by an issue-as-reverse inquiry. Discount bank debentures are issued by banking institutions, such as Aozora Bank (mainly former Long-term Credit Bank related banks). Those banks are commissioning securities companies to sell them on their behalf.
Meanwhile, interest-bearing bank debentures are issued in two ways: issuing debentures through a public offering on a fixed day and selling them during a certain selling period.

----- Ref. P.88-91, [Securities Market in Japan 2010, JSRI]
§1.04 Credit-Rating Agencies and the Credit Rating of Bonds

Credit rating was introduced to Japan in the 1980s, and it has become general practice in issuing of and investing in corporate bonds.

In Japan, bonds with a credit rating of BB, B, CCC, CC, or C which are called “junk bonds” or “high yield bonds,” did not exist in the primary market because of a policy that excluded bonds that did not meet the eligibility standards established by the market participants.

However, today there are no more such regulations because the eligibility standards were abolished in 1996. Nevertheless, few BBB-rated bonds, let alone junk bonds, have been offered on the market.

Having suffered severely from the latest financial crisis, in mid-2007 corporate bond issuance began to show signs of recovery globally from summer 2009.

In Japan as well, the recovery trend in corporate performances and robust demand from financial institutions, particularly regional financial institutions, supported a rebound in demand for corporate bonds with credit ratings of A or higher.

However, with the exception of bonds with relatively stable earnings, such as railway companies, bonds with low credit ratings have not received the same positive treatment in Japan, despite the reverse trend in Europe and the United States, and their issuance remains at low ebb.

One explanation is that—fearful of default and averse to risk—most of the institutional investors in Japan do not invest their funds in assets other than those with a credit rating of A or higher.

Designated rating agencies now include both domestic players, such as the Rating and Investment Information (R&I) and the Japan Credit Rating Agency (JCR), and global agencies, such as Standard & Poor’s, Moody’s and Fitch.

In the middle of 2000s, they expanded their range of activities to credit ratings of municipal and FILP agency bonds.

..... Ref. P.91-93, [Securities Market in Japan 2010, JSRI]
§1.05 Introduction of register system for CRA in Japan

[1] New Regulation system is in force since April 2010.

Five Credit rating agency registered on Sep.30 2010. The previous system, i.e. Designated Rating Agencies System is going to be abolished on Dec.31 2010.


Since Oct.2010, in soliciting customers, Financial Instruments Business Operators, etc. shall not use the credit ratings provided by unregistered CRAs, without informing customers of (a) the fact that those CRAs are not registered and (b) the significance and limitations of credit ratings.

[3] Partial Amendment to Prospectus, etc.'s Form

As from Jan 2011, bond issuers, when they solicit credit ratings to a registered CRA for the public offering, must disclose of outcome their credit ratings and explain assumptions and limitations of credit ratings, in their prospectus etc.

[4] Related laws and regulations

- Financial Instruments and Exchange Act (FIEA)
- Cabinet Ordinance on Financial Instruments Business, etc.
- Cabinet Ordinance on Disclosure of Corporate Information, etc.
  - Cabinet Ordinance on Definitions under Article2 of the Financial Instruments and Exchange Act (FIEA): etc.

(Tables for Reference)
Introduction of Regulation for CRAs
Summary of the “Guidelines for Supervision of Credit Rating Agencies”
Summary of Credit Rating Agencies Regulation

(The accountability of securities companies, etc. came into force on October 1, 2010)
Summary of the “Guidelines for Supervision of Credit Rating Agencies”

**Basic concept**
- Aims to ensure appropriate business operations of credit rating agencies, and to bring about appropriate exercise of their functions.
- Care is needed to avoid a mechanical and uniform application.
- As stipulated in Cabinet Office Ordinance, be careful not to get involved in any “individual credit ratings” or in the “specific details of how credit is assessed.”

**Main supervisory evaluation points and various administrative procedures**

- **Obligation to develop systems**
  - Keep in mind that systems development cannot be assessed as “unsound business operations” within a group.
  - Non-Japanese-related ratings determined at an overseas location by a foreign corporation are not given an opinion in Japan.
  - Whether the credit rating agency examines the validity and effectiveness of these policies and procedures, and revises revisions as necessary.

- **Prohibited acts**
  - Whether the credit rating agency has developed systems—nearly it can confirm, when necessary, that it does not contain any prohibited acts prescribed in the FIEA or Cabinet Office Ordinance.

- **Various administrative procedures**
  - Various administrative procedures during an examination for registration check whether the operational control systems of the registration applicant are appropriate and suited to the characteristics, etc., of its business.
  - Whether the credit rating agency has a foreign corporation established as an agent or a representative in Japan.
  - Whether a business operation is established in Japan.

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(Reference) Summary of Credit Rating Agency Regulations

- **Revised Financial Instruments and Exchange Act**
  - Passed in June 2009

- **Revised Cabinet Office Ordinance**
  - Promulgated in December 2009

**Main subclasses of the obligations for systems development**
- **Quality control in the rating process**
- **Expansion of a consultative body which includes outside persons**
  - **Supervisory committee**
  - **Legal compliance**
  - **Accommodation provision**

**Main regulations for registered business operators (credit rating agencies)**
- **Duty of good faith**
  - Quality control in the rating process, etc.
  - prohibition of name lending
  - Prohibition of the provision of ratings to: close related persons
  - Prohibition of the concurrent provision of rating and consulting services, etc.

- **Duty to disclose information**
  - Timely disclosure of information (rating determination policy, etc.)
  - Periodic disclosure of information (explanatory documents, etc.)

- **Prohibited acts**
  - Quality control in the rating process, etc.

- **Duty to develop systems**
  - Quality control in the rating process, etc.
  - Prohibition of name lending
  - Prohibition of the provision of ratings to: close related persons
  - Prohibition of the concurrent provision of rating and consulting services, etc.

- **Duty to disclose information**
  - Timely disclosure of information (rating determination policy, etc.)
  - Periodic disclosure of information (explanatory documents, etc.)

- **Also provisions for the authorities to visit the submission of reports, conduct on-site inspections and take administrative action**

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This version is not final
Subject to change
§1.06 Market Category - Public Offering and Private Placement

In Japanese bond market, the Financial Instruments and Exchange Act (the FIEA) distinguish between [1] a public offering and [2] a private placement (PP) of securities very clearly, irrespective of whether they are domestic or foreign.

[1] Public Offering
A public offering is generally subject to requirements to disclose the solicitation documents stipulated in the FIEA, whereas a private placement is not.

Disclosure requirements for Public Offering:
Disclosure requirements by way of filing a Securities Registration Statement (SRS) and delivering a Prospectus under the FIEA and a related Order for Enforcement and Cabinet Office Ordinances are applicable to the solicitation of the public, i.e. public offering, for either an initial issue or sale of existing securities.

Cases that are not deemed to be a public offering:
Following categories are not deemed to be a public offering. Those are offering
(2-1) to a small number of investors (the SN-PP) or
(2-2) to qualified institutional investors (the QII-PP) or
(2-3) to specified investors (the Offer to SI).

[2] Private Placement
The FIEA prescribes the following three categories as a private placement.
As to newly-issued securities, any offering other than these three categories is categorized as a public offering:

(2-1) the SN-PP:
The SN-PP is a private placement to less than 50 people. The requirements for the SN-PP are as described below.

(i) The total number of persons to whom the solicitation of an offer for acquisition is to be made within any six month period (in case of newly-issued securities) or one month period (in case of already-issued securities) is 49 or less (the Small Number Private
Placement):

In calculating the number of solicited persons for the purpose of the SN-PP which is less than 50 during a six-month period or one-month period, the number of the QIIs is excluded from the total number of solicited persons only if the offer to such QIIs fulfills the requirements of the QII-PP set forth below (2-2) (i) to (iii).

(ii) The kind of securities offered is not the same as (a) securities for which continuous disclosure is made or (b) “securities for specified investors.”

(iii) Depending on the kind of securities, a certain restriction of transfer is required. For instance, a SN-PP of bonds requires either (a) restriction of transfer other than en bloc transfer or (b) number of the investment unit (e.g., number of bond certificates to be delivered) being less than 50 and dividing the investment unit being prohibited. Such transfer restriction must be (x) written on the bond certificates to be delivered, (y) written on the offering document or (z) disclosed through the book-entry system of JASDEC.

In addition, in general, the offer of the securities must deliver a document, which states that no SRS has been filed for the SN-PP and describes the contents of the transfer restriction.

(2-2) the QII-PP:

The QII-PP is an offer for acquisition to be made exclusively to Qualified Institutional Investors. The requirements for the QII-PP are as described below.

(i) Offerees are limited to QIIs.

(ii) The kind of securities offered is not the same as (a) securities for which continuous disclosure is made or (b) “securities for specified investors.”

(iii) Any transfer of the securities is prohibited unless the transferee is a QII: such transfer restriction is written on the certificates of the securities to be delivered or offering document, or disclosed through the book-entry system of JASDEC.

In addition, the offeror of the securities must deliver a document, which states that no SRS has been filed for the QII-PP and describes the contents of the transfer restriction.
With respect to a private placement of newly-issued securities for QIIs, if the issuer of the securities is a foreign entity, the issuer is required to appoint an agent that is a resident of Japan.

(2-3) the Offer to SI: (Newly added in 2008)

The solicitation for acquisition is to be made exclusively to Specified Investors. Legally, the Offer to SI is categorized as a type of private placement. However, the economic nature of the Offer to SI can be similar to a public offering because the concept of Specified Investor is much broader than QII (please see §1.07 - Definition of the Specified Investor) and the number of offerees is not limited under the Offer to SI.

The summary of the requirements for the Offer to SI are as described below.

(i) Offerees are limited to Specified Investors.

(ii) Solicitations are made by financial instruments business operators, etc (i.e., securities companies and other financial institutions authorized to operate securities business), in general.

(iii) The kind of securities offered is not the same as securities for which continuous disclosure is made.

(iv) Solicitation is made on the condition that a purchase agreement is executed, which provides among other things, that the person who has purchased the securities shall not transfer them otherwise than to Specified Investors or certain non-resident of Japan.

Since the Offer to SI is categorized as the PP, the disclosure requirements do not apply.

However, the issuer of the securities is required to provide concise information in respect of the securities and the issuer. For detail, please see §1.07.

[3] Small Amount Placement

A public offering shall not be made unless the issuer has filed an SRS with the Director-General of the Kanto (or other applicable) Local Finance Bureau unless any one of the exemptions applies. One of such exemptions is a Small Amount Placement,
under which the total amount of the issue price of securities offered in Japan (the "Issue Price") is less than 100 million yen. In calculating the 100 million yen, amount of certain simultaneous and/or past offering shall be aggregated.

The Small Amount Placement is not literally a private placement, but rather a special form of public offering exempted from the filing requirement under the FIEA.

In the case of the Small Amount Placement where the Issue Price is less than Yen 100 million and more than 10 million yen, a Securities Notice (the "SN") rather than the SRS must be submitted to the Local Finance Bureau. The SN, which is not made available for public inspection, must be filed by a day before the commencement of solicitation.


As to already-issued securities (i.e., secondary transactions), there are several exemptions from disclosure requirements in addition to those described above. Such exemptions include the following:

(Reference) As stated above in § 1.01 Corporate Bonds, Asset backed bonds and Nonresident bonds are subject to disclosure requirements under Financial Instruments and Exchange Act of Japan (FIEL). Government bonds and Public bonds etc. (see §2.05) are exempt from the disclosure requirement.

(i) Transactions at stock exchanges;

(ii) Block trades between financial instruments business operators, etc. (i.e., securities companies and other financial institutions authorized to operate securities business) or Specified Investors;

(iii) Certain transactions between financial instruments business operators, etc.;

(iv) Sale of securities (for which any PP has not been made in the past) between people who have close relationships with the issuer (e.g., directors of the issuer, major shareholders of the issuer, parents or subsidiaries of the issuer) or financial instruments business operators, etc. (provided, that transactions both parties of which are financial instruments business operators, etc. are excluded):
(v) Sale of securities (for which any PP has not been made in the past) by a person who is not listed in (iv) above;

(vi) Public offering of already-issued securities for which continuous disclosure is made; and

(vii) Public offering of certain foreign-issued securities by financial instruments business operators, etc.

Transactions listed (i) to (v) are excluded from the definition of “public offering” and therefore the disclosure requirements do not apply.

Transactions listed (vi) and (vii) are categorized as public offerings, but disclosure requirements are modified.

For transaction (vi), a SRS is not required, and Prospectus and SN are required only under limited circumstances.

For transaction (vii), a SRS, Prospectus and SN are not required, although the financial instruments business operators, etc. offering the foreign securities must, in general, provide concise information on the securities and the issuer at the time of offering, any time requested by the investors after the offering and at a time when certain material event (such as default of the issuer) occurred after the offering.
§1.07 Definition of the Specified (Professional) Investor

[1] Breakdown of the Specified (Professional) Investor

The following categories are specified investors.

i. Qualified Institutional Investors (meaning persons specified by a Cabinet Office Ordinance as those having expert knowledge of and experience with investment in Securities);

ii. The State (Japan);

iii. The Bank of Japan; and

iv. Investor Protection Funds, and Other juridical persons specified by a Cabinet Office Ordinance (excluding those that are deemed to be non-specified investors according to agreements (opt-out)).

v. Corporations and individuals that are deemed to be specified investors according to agreements (opt-in).

Qualified Institutional Investors (QIIs) include securities companies, investment management companies, investment corporations, foreign investment corporations, banks, insurance companies, certain pension funds, general partners of certain partnerships.

Juridical persons referred to in iv above include companies whose shares are listed on stock exchange(s) in Japan, companies whose stated capital is likely to be 500 million yen or more and foreign corporations. The specified investors listed in iv above may opt out of the status as specified investors by an agreement with the financial instruments business operator, etc.

Corporations and individuals that are not included in any one of i to iv above may opt in by an agreement with the financial instruments business operator, etc.

To become a specified investor, an individual is required to have net asset of 300 million yen or more, financial assets of 300 million yen or more and investment experience at least one year.

The following is the FSA's statement related to the new market for Specified Investor. FSA (Financial Services Agency) statement (extract) related to the development of markets intended for professionals on December 21, 2007

Plan for Strengthening the Competitiveness of Japan's Financial and Capital Markets

I. Creation of reliable and vibrant markets

(ii) Development of a framework for markets intended for professionals

In other countries, markets with a high degree of freedom intended for professional investors are expanding, such as the AIM (Alternative Investment Market) in the United Kingdom and the market based on Rule 144A of the United States Securities and Exchange Commission (SEC). This trend has been intensifying the international competition in creating attractive markets.

Investor protection, including through disclosure, will continue to gain greater importance in Japan. However, it is also essential to differentiate professional investors from general investors and allow the former more freedom in transactions under the principle of self-responsibility, from the viewpoints of making the country’s financial and capital markets more vibrant and strengthening their international competitiveness.

Measures will be taken to establish markets among professionals that allow a high degree of freedom in transactions. The aim of this work is to raise the attractiveness of Japan’s financial and capital markets as the places for financing and investment by expanding financing opportunities for foreign companies and Japanese start-ups in Japan, and to promote financial innovation through competition among professional investors. To this end, a framework utilizing the existing systems, including of private offerings to professionals, will be put in place by the end of 2008. This will be followed by the development of a new framework, based on new disciplines, for an exchange market, the participants of which will be expanded to include professional investors.


Under the FIEA, the financial instruments exchanges are allowed to create a market in which the listed securities may not be transferred to any person other than specified investors or certain non-residents of Japan. Such financial instruments exchange
market is defined as “Specified Financial Instruments Exchange Market” in the FIEA.

Securities that are listed on a Specified Financial Instruments Exchange Market but not listed on a regular financial instruments exchange market are defined as “Specified Listed Securities” in the FIEA. Holders of Specified Listed Securities may not transfer them to any person other than specified investors or certain non-residents of Japan both at the financial instruments exchange and over-the-counter, unless the issuer of the securities files a SRS in advance.

Note that the Tokyo Stock Exchange Group will limit the investors to the TOKYO PRO-BOND Market as described in the §1.08 [3] (10).
§1.08 TOKYO PRO-BOND Market: New Listing System in Japan

[1] Preface

Happily, in the past several years the impediments isolating the domestic market from foreign markets have been removed in Japan through the efforts of policymakers and market participants.

In 2008, the Financial Services Agency of Japan revised the FIEA as part of its plan to enhance the competitiveness of Japan’s financial and capital markets, establishing the legal framework for markets oriented towards professional investors (an offering system for Specified Investors and Specified Financial Instruments Markets stipulated in the FIEA). This provides the legal framework for the establishment of a new securities market, which is different from the general public offering system and has wider range of investors than the U.S. Rule 144A market.

In addition, the taxation system was reformed in fiscal 2010 to reduce the tax on revenues from domestic bonds held by non-residents to zero.

Here we see the opportunity to put an end to the state of isolation of Japan’s domestic markets.

Having done away with these twin constraints in the legal and taxation systems that have conceptually separated domestic bonds from Eurobonds and other international bonds in Japan, if appropriate rules are provided for disclosure and registration (listing).

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1 The Rule 144A market is a market exempted from disclosure for private offerings under Rule 144A introduced to the Securities Act of 1933 by the U.S. Securities and Exchange Commission in 1990. When bonds and other instruments targeting professional investors are issued in the U.S. markets, rather than employing public offerings, which entail stringent legal standards for document disclosure, it is normal to follow Rule 144A (Securities Act of 1933) and make the offering exclusively to qualified institutional buyers.

In the U.S., the Rule 144A market is available as a domestic professional investor market and the Regulation S market is available as an offshore professional investor market that waive disclosure requirements. Regulation S provides for a safe harbor (i.e. exemption from disclosure) in the case of transactions conducted outside the U.S., while Rule 144A provides for a safe harbor even in the case of transactions within the U.S. for qualified institutional buyers. In both cases, resale within the U.S. is on principle restricted to qualified institutional buyers under Rule 144A.

The precursor of Rule 144A was Regulation D (1982), composed of Rules 501 to 508, and concerning private offerings made within the U.S. Regulation D stipulated the conditions for accredited investors.

However, while Regulation D entailed an asset test, the precondition that an investor possessing assets had the ability to make judgments on all investments was criticized as being ludicrous, and Rule 144A replaces the asset test with an ownership and investment securities test. (i.e. it incorporates elements of experience in investment in risk securities).
in future, the necessity for separating domestic and international bonds will decline, and we will witness a radical improvement in the mobility and the convenience of the Japanese corporate bond market.

[2] New Listing System in Japan

I. Objective

The Tokyo Stock Exchange Group will establish the Listing System as outlined below for bonds on the TOKYO PRO-BOND Market. The outline framework for the TOKYO PRO-BOND Market was open for public consultation until December 9, 2010. Approval and release of the new rules is assumed to be around January 2011. The first issue of bonds is assumed to be around April 2011.

- The TOKYO PRO-BOND Market will be a Specified Financial Instruments Market as prescribed in Article 2, Paragraph 32 of the FIEA.
- The TOKYO PRO-BOND Market will be operated by TOKYO AIM, Inc. as a different market from the TOKYO AIM stock market. The types of securities that may be listed on the TOKYO PRO-BOND Market are as follows.
  - Straight Bonds: Corporate Bonds listed in Article 2, Paragraph 1, Item 5 of the FIEA (including bonds issued by mutual companies, but excluding bonds with warrants (as prescribed by Article 2, Paragraph 22 of the Companies Act).
  - Bonds Issued by Government Agencies: Bonds issued by legal entities pursuant to the special laws listed in Article 2, Paragraph 1, Item 3 of the FIEA.
  - Bonds Issued by Funds: Investment corporation debentures and those foreign investment securities that are similar to investment corporation debentures, as prescribed in the Act on Investment Trusts and Investment Corporations, as outlined in Article 2, Paragraph 1, Item 11 of the FIEA.
  - Municipal Bonds: Municipal Bonds listed in Article 2, Paragraph 1, Item 2 of the FIEA.
  - Specified Company Bonds: Specified Company Bonds prescribed in the Act on the Liquidation of Assets listed in Article 2, Paragraph 1, Item 4 of the FIEA.
  - Securities or notes issued by foreign countries or foreign entities: Those maintain the qualities of the above.
II. Listing System

1. New Listings

a. Initial Listing Application

- The listing of bonds on the TOKYO PRO-BOND Market will be carried out through an application by issuers.

  ✓ It will not be necessary to retain a nominated adviser (J-Nomad), which is required for TOKYO AIM stock market, in the TOKYO PRO-BOND Market.

- The Initial Listing Applicant will submit an Initial Listing Application and Initial Listing Application Documents to the Exchange by the time of listing.

  ✓ The Initial Listing Applicant may consult or make inquiries to the Exchange prior to listing regarding the Initial Listing Application.

  ✓ The Initial Listing Applicant shall state in the Initial Listing Application Documents that there are no false statements in the Documents.

- The Initial Listing Applicant will disclose Specified Securities Information (specified securities information prescribed in Article 27-31 of the FIEA) at the time of an initial listing of bonds.

  ✓ Specified Securities Information will be prepared based on the format stipulated by the Exchange.

  ✓ The language of disclosure of Specified Securities Information will be either Japanese or English, or both.

  ✓ Specified Securities Information will be comprised of: (1) Program Information (equivalent to the shelf registration documents under the FIEA); and (2) Personal Information (equivalent to supplemental shelf registration documentation). (It will be possible to include the content of program information in personal information, or for the information to consist of personal information only).

  ✓ In the case where an issuer publishes a part of this information prior to the issuance of the bonds in accordance with the rules and regulations of the Exchange, such issuer is allowed to prepare the Specified Securities Information only with remaining information. TOKYO PRO-BOND Market call the former “Program Information” and the latter “Individual Information”.

In the case where the issuer publishes the Individual Information after the registration of Program Information, the listing will be accepted promptly after the submission of the Individual Information.
The format of Specified Securities Information ((1) Program Information; and (2) personal information) will be discussed and decided at a later date, in accordance with the formats for shelf registration documents and supplemental shelf registration documentation in the FIEA.

Financial Information will be in a format that makes reference to the Program Information and the Issuer Filing Information.

If the Initial Listing Applicant is a continuous disclosure company (a company which has submitted the Annual Securities Report for one year), the FIEA stipulates that announcement of Issuer Filing Information is not required and that Specified Securities Information ((1) Program Information; and (2) Personal information) shall contain a notice that the company submits the Annual Securities Report.

Discussions and decisions regarding disclosure formats in English will be carried out with reference to systems such as the Euro-market.

b. Qualification Requirements for Initial Listing Companies

The Initial Listing Applicant must satisfy all of the requirements listed below when listing bonds on the TOKYO PRO-BOND Market:

1. The said bonds obtain a credit rating from a credit rating agency (a credit rating agency as prescribed in Article 2, Paragraph 36 of the FIEA.).
   ✓ A credit rating for the above-mentioned Program Information may be used as the credit rating.

2. The securities company that will serve as Managing Underwriter for bonds to be listed on the Exchange will be registered on the Exchange’s Managing Underwriter List.
   ✓ Any securities company that wishes to register to appear on the Managing Underwriter List can apply to do so to the Exchange. The Exchange will then decide whether to approve the registration based on consideration of the company’s track record in corporate bonds underwriting. The Exchange will also assess the ongoing eligibility of securities companies to be included on the Managing Underwriter List.
   ✓ The requirements for companies registered on the Managing Underwriter List will be different to those for J-Nomads in that they will have no duties to the Exchange in respect of the Qualification Requirements for Initial Listing Companies and no post-listing duties.
c. Approval of Listing

- Once it has confirmed that the Initial Listing Applicant satisfies the Requirements for Initial Listing, the Exchange will approve the listing of the bonds and publicly announce it in a timely fashion.

- In instances where it is deemed that listing the bonds in the said listing application would damage the reputation of the TOKYO PRO-BOND Market, or there is potential for the disruption of smooth market operations, the Exchange will not approve the listing.

2. Obligations after Listing

a. Timely Disclosure

- The issuer of listed bonds must disclose the Issuer's Information in a timely, accurate, fair and investor-oriented manner.

- The matters that the issuer of listed bonds will be required to disclose will be different from that required for equity listings. The issuer of listed bonds will only be required to disclose matters such as dissolution, bankruptcy or default. Disclosure of other information will be optional.

- Note: Legally, in the case of corporate bonds, the important matters subject to insider trading regulations are limited to dissolution, bankruptcy or default (Article 6, Paragraph 6, Item 6 of the FIEA, Article 32-2 of the Enforcement Order of the FIEA, and Article 58 of the Order for Enforcement on Regulation of Trading of Marketable Securities.

- Timely disclosure obligations will not be imposed on sovereign debt issuers.

b. Financial Information

- The issuer of listed bonds will publicly announce Issuer Filing Information (Issuer Filing Information as prescribed in Article 27, Paragraph 32 of the FIEA) at least once per year.

- The details of Issuer Filing Information will be considered and decided at a later date.

- If the issuer of listed bonds is a continuous disclosure company, the issuer of listed bonds is not required to announce Issuer Filing Information under the FIEA.

3. Delisting, etc.
a. Delisting other than by Application
   ■ In instances where nondisclosure of required disclosure documents, serious false statements and other events which the Exchange deems delisting appropriate, the Exchange will delist the said listed bonds.

b. Warning measures, etc.
   ■ In instances deemed necessary, the Exchange will take warning measures, or impose a penalty or other means on the issuer of listed bonds, and if deemed necessary may publicly announce this measure.

4. Listing Fees
   ■ Listing Fees to be paid by the issuer of listed bonds to the Exchange will be charged on the registration of Program Information and listing of the bonds.
      ✓ The specific levels will be discussed and decided at a later date.


The Exchange will launch a Trading System and a Settlement and Clearance System, but investors can choose to trade in the OTC market. It is assumed that the main market for the bonds will be the OTC market.

   It is assumed that the main market for the bonds will be the OTC market.

1. Trading System
   ■ The Exchange shall prepare a trading system as outlined below for the conduct of trading in bonds in the TOKYO PRO-BOND Market.

   (1) Form of Orders
      ■ The Exchange will accept ask and bid orders from Trading Participants.

   (2) Order Acceptance Hours and Trading Hours
      ■ The order acceptance hours and the trading hours shall be from 9:00 to 11:00 and from 12:30 to 15:00.

   (3) Types of Transactions
      ■ The types of transactions shall be Regular Transactions.

   (4) Method of Closing Trades, etc.
A lower sell quote shall have precedence over higher sell quotes, and a higher buy quote shall have precedence over lower buy quotes. Where two or more bids or offers are made at the same price, precedence shall be determined in the order of the time at which such bids or offers were made.

The price will be determined by Zaraba (continuous session) method.

(5) Order Method, etc.

- Orders shall be conducted by simple methods such as email.
- The unit for bid and ask prices shall be ¥0.01 for yen-denominated securities. The Exchange will determine the unit for bid and ask prices for each foreign-currency-denominated security.
  - For foreign-currency-denominated securities, TOKYO PRO-BOND Market will attach trading value information denominated in yen with the execution notice.

(6) Trading Unit

- Trading Unit shall be Face value ¥100 million for yen-denominated securities and Face Value for foreign-currency-denominated securities.

(7) Announcement of Trading Information

- Trading Information will be announced shortly after the trading, on the website of the Exchange. (For foreign-currency-denominated securities, the trading value converted into yen will also be announced.)
- The Exchange Rate to convert foreign-currency-denominated securities into yen will be announced on the website of the Exchange before the start of the trading session.
  - Real-time transmission using the TSE’s Market Information System (MAINS) of total daily trading volumes on the TOKYO PRO-BOND Market will not be conducted.

(8) Notification of Orders

- The Exchange will notify detailed particulars on orders (the name of the security, bid or ask, quote price, quantity) utilizing simple methods such as email.

(9) Trading Fees

- Trading fees will be charged on both selling and buying trading participants at the matching of orders.
  - The specific levels will be discussed and decided at a later date.

(10) Investors

- The Bond Market will be offered to Qualified Institutional Investors, et al who
are not subject to separate withholding in Interest Income Taxes and to Nonresidents, et al who are exempted from Interest Income Taxes.

2. Clearing and Settlement System

- Clearing with respect to trading of bonds in the TOKYO PRO-BOND Market will be handled by Japan Securities Clearing Corporation.
  - Clearing and settlement of foreign-currency-denominated securities will be dealt with by the trading value TOKYO PRO-BOND Market converted into yen.
  - The settlement will be subject to Non-DVP arrangement.

- Settlement with respect to trading of bonds in the TOKYO PRO-BOND Market will be handled by The Book-entry Transfer System for Corporate Bonds of Japan Securities Depositary Center, Inc.
  - As for bonds which are not handled by Japan Securities Depositary Center, Inc., trading participants who are involved in the transactions will clear and settle them directly.
§1.09 Commissioned company for bondholders System

[1] Summary

In cases where a company will issue bonds in Japan, generally speaking the Company must specify a commissioned company or person for bondholders and entrust the receipt of payments, the preservation of rights of claim on behalf of the bondholders and other administration of the bonds to that manager; provided, however, that this shall not apply in cases where the amount of each bond is 100 million yen or more by the Companies Act, and other cases prescribed by the applicable Ordinance of the Ministry of Justice as cases where it is unlikely that the protection of bondholders will be compromised.

A drastic reform of the conventional corporate bond trustee system was carried out by amending the Commercial Code in June 1993. Under this amendment, the conventional name “bond trustee company” was changed to “commissioned company,” and its function was clarified.

More specifically, (1) the establishment of a commissioned company was made mandatory, in principle, and the eligibility for becoming one is restricted to banks, trust companies, and companies that have received a license under the Mortgage Bond Trust Law; (2) services to be provided by a commissioned company are restricted to the management of bonds that have been issued and are outstanding; and (3) the power, duty, and liability of the commissioned company have been clarified.

The impact of the amendment may be summarized as follows:

(1) The fee the trustee bank had been collecting was renamed “commissioned companies fee,”;

(2) By instituting exceptional provisions with respect to the mandatory establishment of a commissioned company (this applies when the face value of a bond is not less than ¥100 million), issuers can appoint a fiscal agent (FA); and

(3) The lump purchases of defaulted bonds that trustee banks had been making were discontinued, and this practice has since become established.

Under the New Companies Act adopted in June 2005 (enforced in May 2006), a
commissioned company for bondholders and its liability and power have been expanded.

More specifically, (1) under the former Commercial Code, the term “administration of bond” referred only to the exercise of power legally granted to the commissioned company and person for bondholders and did not include the exercise of power based on an agreement, etc., commissioning the administration of bonds (contractual power); under the new Companies Act, however, the exercise of the contractual power is included in “the administration of bonds” and the commissioned company and person for bondholders owes the duty of impartiality and good faith and the duty to exercise reasonable care and skill in exercising such contractual power; (2) when the agreement commissioning the administration of bonds contains a provision to that effect, the commissioned company and person for bondholders act in relation to filing a lawsuit and taking bankruptcy or rehabilitation proceedings for the bond as a whole without obtaining a resolution of the bondholders’ meeting; and (3) in taking steps to protect the creditors in the case of a capital reduction or a merger, the commissioned company and person for bondholders may, in principle, object to such capital reduction or merger without obtaining a resolution of the bondholders, meeting.

----- Ref. P.93-95, [Securities Market in Japan 2010, JSRI]
§1.10 Commissioned company for bondholders related issues

(Under review: to be followed later)
§1.11 JSDA’s Self-regulatory Rules and Guidelines for the Bond Market

In light of most of the bond transactions being conducted via OTC in Japan, Japan Securities Dealers Association (JSDA), the sole SRO for the securities industry in Japan, has issued a variety of rules and market practices for bond market participants.

Some of the oldest of the Association’s self-regulatory rules were introduced as administrative guidance by the financial authority. As the role of the financial authority and the Association became clearly separated, these rules fell under the purview of the JSDA, and today function as self-regulatory rules.

The main categories of these rules and guidelines are as follows:

[1] Self-regulatory rules

JSDA members must comply with these rules. Their coverage ranges from items observed in outright transactions (purchase or sale) such as compliance with the laws and regulations, maintenance of fairness of transactions, prohibition of extraordinary transactions (*), preparation and maintenance of trading records, and reporting of trade turnovers to items to be complied with in special transactions such as repurchase transactions and OTC options transactions (such as requiring contracts, limiting the types of counterparties, etc.). Regarding the rule requiring contracts, JSDA has prepared a model format that has become the de facto standard in Japan. When Association members violate these rules, they are subject to disciplinary action by the Association (if an Association member commits a breach of the rules together with non-Association member (customer), only the Association member is subject to the disciplinary action).

(*) (Extraordinary Transactions): Article 16 of JSDA’s Regulations Concerning Publication of Over-the-Counter Trading Reference Prices, etc., of Bonds and Trading Prices prescribes that the Association Members must not affect 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"). (1) 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); (2) 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); or (3) 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.

The JSDA takes into account market conditions and the practical reality of transactions in establishing, revising and abolishing rules for the purpose of achieving fair and smooth transactions in the Japanese market, thereby contributing to the protection of investors.

During the rule making procedure, a draft of rules is prepared first through deliberations by mainly Association members, subjected to public comment and other processes, and finally approved by the Association.

(The currently available JSDA regulations for bond transactions)

*Regulations Concerning Publication of Over-The-Counter Trading Reference Prices, etc., of Bonds and Trading Prices
*Detailed Rules Relating to The Regulations Concerning Publication of Over-The-Counter Trading Reference Prices, etc., of Bonds and Trading Prices
*Regulations Concerning Publication, etc. of Over-The-Counter Quotation of Corporate Bonds, etc. for Retail Customers
*Regulations Concerning Publication, etc. of Over-The-Counter Quotation of Corporate Bonds, etc. for Retail Customers
*Regulations Concerning Publication, etc. of Over-The-Counter Quotation of Corporate Bonds, etc. for Retail Customers
*Regulations Concerning Publication, etc. of Over-The-Counter Quotation of Corporate Bonds, etc. for Retail Customers

Corporate Bonds
*Regulations Concerning Handling of Sale and Purchase of Bonds with Options
*Regulations Concerning Handling of Conditional Sale and Purchase of Bonds, etc
*Regulations Concerning Handling of Transaction of Bonds, etc. with Delayed Settlement
*Regulations Concerning Handling of Short Sale and Lending Transaction of Bonds
*Regulations Concerning Distributions, etc. of Securitized Products

Guidelines are practical rules that JSDA requests participants in the bond market to comply with (thus recognized as “best practice”). As they are merely practices, those who don’t comply with them are not penalized. However, as voluntary compliance with these guidelines by the overall market contributes to smooth and efficient transactions, most market participants observe the guidelines. Consequently, the JSDA collects and considers the opinions of market participants when setting new guidelines or revising/abolishing old ones.

Currently, JSDA has published guidelines concerning delivery and settlement practices such as “Deadline for Settlement (Cut-off time)”, “Handling of Fails Charges”, and Order conclusion practices for JGB When-Issued Transactions.

[3] Others

Besides the above, JSDA issues from time to time notices to Association members in advance regarding standard procedures, etc, such as the standard calculation method of accrued interests, to eliminate the necessity of getting individual consensus between related parties regarding the unification of procedures among market participants.
§1.12 Bankruptcy Procedures and Bonds

There are four (4) statutory insolvency proceedings that apply to Japanese corporations. Each can be categorized into one of two general types, depending on whether the aim of the proceedings is to liquidate the company (“Liquidation-type Proceedings”) or rehabilitate the company (“Rehabilitation-type Proceedings”):

1. Liquidation-type Proceedings
   (a) Bankruptcy proceedings (hasan) under the Bankruptcy Act; and
   (b) Special liquidation proceedings (tokubetsu seisan) under the Companies Act.

2. Rehabilitation-type Proceedings
   (a) Corporate reorganization proceedings (kaisha kosei) under the Corporate Reorganization Act; and
   (b) Civil rehabilitation proceedings (minji saisei) under the Civil Rehabilitation Act.

At the time of the filing of the application for or the commencement of any of those insolvency proceedings or both, depending on the language of the default clause of the relevant bonds, the bonds will be accelerated. If a commissioned company for bondholders has been appointed for the bonds, the commissioned company will act for the benefit of the bondholders as creditors of the issuer in the proceedings. If no commissioned company has been appointed, individual bondholders will be expected to act for themselves in the proceedings.

As an alternative to commencing one of the four (4) types of statutory insolvency proceedings above, a Japanese corporation in financial distress may seek to negotiate an out-of-court restructuring of the corporation with its creditors. In the course of such negotiation, bondholders’ meeting may determine the amendment to the terms and conditions of the bonds, such as installment repayment of principal amount or reduction of the interest rate, though a court approval will be required to have the decision of the meeting take effect. The resolution requirement for an agenda depends on the content of the agenda. This statutory bondholders’ meeting system set out in the Companies Act is applicable only to the bonds issued by Japanese corporate issuers under Japanese law.
Questionnaire 2: Primary and secondary market related regulatory frameworks

(The following items are just for the reference)

- **Issuing debt instruments (Issuer’s regulation / rule) (Primary Market related)**
  (The following items are just for the reference)
  - Disclosure requirements (filing, prospectus, etc.)
  - Credit rating requirements
  - Exemptions for private issues
  - Exemptions for specific instrument type, e.g. MTN
  - Minimum lead time (number of business days) for registration approval
  - Availability of shelf registration and associated documentation requirements
  - Regulated suspension period (this may relates to investor protection)
  - Other requirements (Including currency denominations)

- **Buying debt instruments (Investor’s regulation / rule) / (Secondary Market related)**
  (The following items are just for the reference)
  - Continuous disclosure rules or requirements
  - Restrictions for investors (investment grade, etc.)
  - Definition of Qualified Institutional Investors, Professional Investors, if exist
  - Non-resident requirements / restrictions
  - How to ensure market functions for the finding of Fair Price

- **Taxation Framework and Tax requirements**
  (The following items are just for the reference)
  - Withholding tax for CP, Bonds and other instruments (wholesale, retail)
  - Tax reporting requirements for issuer / paying agent
  - Tax exemption requirements for non-residents

- **Regulatory reporting requirements**
  - Reporting requirements in case of direct deal between issuers and investors
  - Reporting requirements in case of cross boarder deal
  - Reporting requirements in the Foreign Currency denominated instruments

- **Challenges / Expected changes**
  - Issues on current regulations / rules
  - Expected regulatory reforms
§2.01 Disclosure Requirements

[1] Securities registration statement (SRS)

In order to make the information contained in the Securities registration statement (SRS) and its attachments accessible by general investors, the FIEA requires the SRS and its attachments to be filed by the issuer with the Director-General of the Kanto Local Finance Bureau or the relevant Local Finance Bureau (sometimes "FB"), and for such filings to remain open for public inspection during a period of five years.

In addition, the issuer must keep such documents at its head office and principal branch offices and make them available for public inspection.

Once the SRS is filed with the relevant Finance Bureau, solicitation may be made, but before the securities are acquired by investors, the registration must have become effective. The registration becomes effective generally by the elapse of 15 days from and excluding the day of filing ("waiting period").

The relevant Finance Bureau may designate a shorter period or may notify the issuer that the registration will become effective immediately or will become effective on or after the day of filing if the relevant Finance Bureau concludes that the public can easily understand the contents of the filed registration documents or the information on the issuer has been widely disseminated to the public.

In many cases, if the issuer is already filing continuous disclosure documents, the waiting period is shortened to seven days.

If, prior to the effective date of the registration there occurs any change with respect to any material fact which should be stated in the SRS, or if there arises any situation prescribed by a relevant Cabinet Ordinance calling for the modification of the contents of the registration documents, the registrant should file an amendment to the SRS.

The relevant Finance Bureau may, but is not obliged to, issue an order for filing an amendment to the SRS if it finds the registration documents defective or insufficient with respect to any material facts stated therein.

Once an amendment to the SRS is filed, the aforementioned waiting period starts, on
or several days after the day of filing of such amendment to the SRS, depending upon the nature of the amendment.

The SRS is generally comprised of three sections: Information Concerning Securities, Information Concerning Issuer, Information Concerning Guarantor and Special Information.

In addition, for the SRS for foreign Specified Securities referred to in § 2.03[3] below, the "Information Concerning the Legal System of the Home Country of the Issuer, etc." must also be disclosed.

In the Securities Markets, in addition to the disclosure requirements, there are Regulations Concerning Securities Transactions under the FIEA designed to ensure fair trade.

[2] Methods of filing the SRS

Following are the methods of filing the SRS.

(1) Complete Disclosure Method
The Securities registration statement (SRS) must be filed by the issuer with the Director-General of the relevant Finance Bureau before the commencement of a public offering.

(2) Attachment Method
Companies that filed annual securities reports for the previous year may attach annual securities reports, semi-annual securities reports or quarterly securities reports and their amendments to the SRS in order to avoid duplicate filing.

(3) Reference Method
Companies that satisfy the requirements for (2) above, list their shares on the Stock Exchanges or OTC markets and also satisfy additional requirements under a Cabinet Ordinance may make reference in the SRS to the documents identified in (2) and extraordinary reports rather than attaching the entire documents.
(4) Shelf Registration Method

Frequent issuers that qualify to use the Reference Method can also use the Shelf Registration Method in order to render their issue more cost-efficient and timely.

Any issuer who satisfies the requirements for registration by the Reference Method referred to above may register proposed offering(s) by filing with the relevant Finance Bureau a "shelf registration statement" setting out the period during which the securities are intended to be offered, the kind of securities, the proposed total amount of offering and the anticipated principal underwriters, in accordance with a Cabinet Ordinance.

The shelf registration becomes effective after a shorter period (usually, seven days) than the period in the case of filing the SRS.

Once the shelf registration becomes effective, no individual SRS need be filed for the offering of any part of the securities covered by the shelf registration but the registrant should file with the relevant Finance Bureau a "supplement to the shelf registration statement" setting out the amount of offering and other terms of the offering.

The shelf registration ceases to be effective upon the expiry of the intended period thereof.

If, prior to such expiry, the offerings of the total amount registered have been completed, the registrant should file a "shelf registration withdrawal statement" with the relevant Finance Bureau.

If, during the effective period of shelf registration, a certain situation arises as prescribed by the FIEA and Cabinet Ordinance, the registrant should file an "amendment shelf registration statement".

No such amendment can be made to increase the total amount of offerings, change the proposed period of offerings, or change the kind of securities subject to the registration.

Special provisions are made with respect to the shelf registration method for CPs.
§2.02 Continuous Disclosure

Any (1) issuer of securities listed on any securities exchange, (2) issuer of securities which were subject to the registration requirement with respect to their public offering for initial issue or sale, and (3) corporation whose number of shareholders at the end of any of the past four business years was 1000 or more, is, generally, required to prepare and file with the relevant Finance Bureau an "annual securities report" and "quarterly securities report" in the case of (1) (limited to the issuers of shares) or "semi-annual securities report" in the case of other issuers every year and, from time to time, an "extraordinary report."

In the case of (1) (limited to the issuer of shares), an “internal control report” is also required. (Collectively referred to as the "continuous disclosure requirement" as required by the FIEA).

Such continuous disclosure requirement ceases when the listed securities are delisted, or upon obtaining the approval of the FSA when the issuer goes into liquidation, suspends its business for an extended period of time or the number of holders of the securities which were sold in the public offering for initial issue or sale is reduced to less than 25 or under certain circumstances set out in the Order for Enforcement.

Any issuer subject to the continuous disclosure requirement should prepare an annual securities report in the prescribed form within 3 months after the end of each of its business years (in the case of foreign governments or corporations, etc., within 6 months) and file the same with the FB as provided in Article 24, Paragraph 1 of the FIEA, for each year as prescribed by the Cabinet Office Ordinance.

If the business year of the issuer subject to the continuous disclosure requirement is one year, such issuer must generally prepare a semi-annual securities report in the prescribed form covering the first 6 months of each business year and file it with the relevant Finance Bureau within 3 months from the end of such six-month period.

If the issuer is a company whose shares are listed on a securities exchange in Japan, the issuer must file a quarterly securities report instead of a semiannual securities report, within 45 days from the end of such quarterly period, in general. Such issuer also has to file an internal control report together with an annual securities report.
When there occurs a certain important event with respect to an issuer subject to the continuous disclosure requirement, it should prepare and file with the FB an extraordinary report without delay.

The annual securities report, semi-annual securities report, quarterly securities report, internal control report and extraordinary report are made available to the public inspection via the Internet, through a system named “EDINET.”

The FIEA contains provisions similar to those applicable to the SRS as to amendments to the annual securities report, semi-annual securities report or quarterly securities report, internal control report and extraordinary report and relevant parties' liabilities resulting from material misstatements and omissions.

In addition, issuers of listed securities are subject to various disclosure requirements prescribed by the relevant securities exchange (timely disclosure).
§2.03 Forms of Initial Disclosure by Foreign Issuers

The Main Categories of Cabinet Ordinance Describing the Forms of Initial Disclosure by Foreign Issuers are as follows.

(1) Disclosure of information concerning Corporations
   Cabinet Office Ordinance on Disclosure of Corporate Information (MOF Ordinance No. 5, January 30, 1973)

(2) Disclosure of information concerning Issuers of Foreign Government Bonds, etc.
   Cabinet Office Ordinance on Disclosure of Information, etc. on Issuers of Foreign Government Bonds, etc. (MOF Ordinance No. 26, April 27, 1972)

(3) Disclosure of Specified Securities as defined under Article 3-4 of the Enforcement Ordinance of the FIEA
   Cabinet Office Ordinance on Information, etc. on Specified Securities (MOF Ordinance No. 22, March 3, 1993)
§2.04 EDINET

Disclosure documents, such as the Securities registration statement (SRS), is filed using the Electronic Disclosure for Investors' NETwork (EDINET), which is an electronic system designed to accept disclosure documents filed under the FIEA.

This system has digitized former paper-based disclosure procedures and was developed in order to make the securities market more efficient by reducing the reporting burden on companies and making it easier for investors to access company information.

Under this system, disclosure documents are filed online to the FB and are made available to the public through the internet.

By using this system, issuers do not have to go to the FB in person to file their disclosure documents.

Furthermore, investors can browse through all of the filed documents on the internet and access issuer information more easily.

The programming languages used to prepare the information required in the disclosure documents are HTML and XBRL.
§2.05 Exempted Securities

Japanese government bonds, municipal bonds, bonds issued by judicial persons pursuant to special law, capital contribution certificates issued by a corporation established by a special law, beneficial certificates of loan trusts, bonds guaranteed by the Japanese government and bonds issued by an international organization of which Japan is a member (e.g. IBRD bonds and ADB bonds) are exempted from the registration requirement.
Questionnaire 3: Trading of Bonds and Trading Market Infrastructure

(The following items are just for the reference)

- **Trading of Bonds**
  - ✓ OTC Trading of Bonds
  - ✓ Bond Repurchase Market
  - ✓ PTS / Trading Systems
  - ✓ Secondary Market Yields and Terms of Bond Issues
  - ✓ Transparency in Bond Pricing
§3.01 Trading of Bonds

In general most of Japanese domestic investors tend to hold bonds till maturity. Having said that, selling bonds for switching, for profit taking and loss cutting are often observed by institutional investors.

In recent years, the bond trading volume in the secondary market has continued to increase.

The trading volume has reached ¥4,154 trillion ($34.78 trillion) in fiscal 2000 and breaking into the level at ¥12,534 trillion ($139.2 trillion) in fiscal 2007.

The sharp increase in the trading volume of bonds may be explained by a number of factors, including the following.

First, the government has continuously been issuing massive amounts of JGBs, resulting in a large increase in those outstanding in the market.

Second, brokers/dealers and other financial institutions including banks have been engaging actively in dealing in bonds for trading gains.

Third, the government started to auction off financial bills (FB) and treasury bills (TB) (integrated into T-bills in 2009), which are now actively traded by market participants with short-term cash management needs.

Fourth, the growing so-called flight-to-quality trend among investors also played a part. The movement into the bond market was prompted by a worsening in Japan’s investment environment against the backdrop of the prolonged economic stagnation in recent years and the turmoil in financial markets.

Additionally, government securities outweigh by far other categories of bonds in overall fixed income trading volume.

The dominance of government debts stems mostly from the difference in liquidity, which in turn is because major players are Japanese banks who have tremendous excess cash and who love outstanding liquidity and BIS zero risk weight of Japanese government debts.
Table §3.01-1. The Scale of Bond Purchasing and Selling

<table>
<thead>
<tr>
<th>Fiscal year</th>
<th>Over the counter</th>
<th>Exchange</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>1975</td>
<td>56 (96.6)</td>
<td>2 (3.4)</td>
<td>58 (100.0)</td>
</tr>
<tr>
<td>1980</td>
<td>281 (96.9)</td>
<td>9 (3.1)</td>
<td>290 (100.0)</td>
</tr>
<tr>
<td>1985</td>
<td>2,515 (94.1)</td>
<td>137 (5.9)</td>
<td>2,672 (100.0)</td>
</tr>
<tr>
<td>1995</td>
<td>3,935 (98.6)</td>
<td>54 (1.4)</td>
<td>3,989 (100.0)</td>
</tr>
<tr>
<td>2000</td>
<td>4,148 (99.9)</td>
<td>5 (0.1)</td>
<td>4,154 (100.0)</td>
</tr>
<tr>
<td>2004</td>
<td>6,635 (100.0)</td>
<td>2 (0.0)</td>
<td>6,637 (100.0)</td>
</tr>
<tr>
<td>2005</td>
<td>7,224 (100.0)</td>
<td>1 (0.0)</td>
<td>7,225 (100.0)</td>
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<tr>
<td>2006</td>
<td>9,808 (100.0)</td>
<td>1 (0.0)</td>
<td>9,809 (100.0)</td>
</tr>
<tr>
<td>2007</td>
<td>12,534 (100.0)</td>
<td>0 (0.0)</td>
<td>12,534 (100.0)</td>
</tr>
<tr>
<td>2008</td>
<td>10,512 (100.0)</td>
<td>1 (0.0)</td>
<td>10,513 (100.0)</td>
</tr>
</tbody>
</table>

Notes: 1. The bond purchasing and selling value of exchanges = their trading volume on the exchanges × 2.
2. These figures include the purchasing and selling value of repurchase agreements.
Source: The Japan Securities Dealers Association.

Table §3.01-2. The Value of Purchasing and Selling, by Type of Bond

| FY     | Govt. bonds (trillions of yen, %) | Municipal bonds (incl. private placement) | Govt.-guaranteed bonds (trillions of yen, %) | Corporate bonds (trillions of yen, %) | Bank debentures (trillions of yen, %) | Corporate bonds with equity warrant (trillions of yen, %) | Total, including others (trillions of yen, %) |
|--------|-----------------------------------|------------------------------------------|---------------------------------|---------------------------------|---------------------------------|---------------------------------|---------------------------------|---|
| 2000   | 3,972 (95.6)                      | 44 (1.1)                                 | 33 (0.8)                        | 44 (1.1)                        | 45 (1.1)                        | 9 (0.2)                         | 4,154 (100.0)                   |   |
| 2004   | 6,317 (95.2)                      | 82 (1.2)                                 | 74 (1.1)                        | 90 (1.4)                        | 33 (0.5)                        | 4 (0.1)                         | 6,637 (100.0)                   |   |
| 2005   | 6,901 (95.5)                      | 56 (0.8)                                 | 81 (1.1)                        | 80 (1.1)                        | 30 (0.4)                        | 1 (0.0)                         | 7,225 (100.0)                   |   |
| 2006   | 9,566 (97.5)                      | 43 (0.4)                                 | 53 (0.5)                        | 59 (0.6)                        | 20 (0.2)                        | 1 (0.0)                         | 9,809 (100.0)                   |   |
| 2007   | 12,323 (98.3)                     | 75 (0.6)                                 | 34 (0.3)                        | 51 (0.4)                        | 18 (0.1)                        | 1 (0.0)                         | 12,534 (100.0)                  |   |
| 2008   | 10,361 (98.6)                     | 39 (0.4)                                 | 19 (0.2)                        | 52 (0.5)                        | 13 (0.1)                        | 1 (0.0)                         | 10,513 (100.0)                  |   |

Notes: 1. The bond purchasing and selling value of exchanges = their trading volume on the exchanges × 2.
2. These figures include the purchasing and selling value of repurchase agreements.
Source: The same as above.
§3.02 Participants in the Secondary Bond Market

Looking at the OTC bond market by type of investors or transaction parties, trading is dominated by bond dealers, such as securities companies and banks.

In trading bonds, it is important that the transaction needs of market participants be met as quickly as reasonably possible.

That said, due to the large number of issues and wide variety of transaction forms, it is not easy to rapidly locate a matching counterparty for a particular transaction. Therefore, in most bond transactions, securities companies or dealer banks act as the counterparty, buying or selling as principal to facilitate client trading.

Furthermore, bond dealers trade bonds based on their own market view, which adds to their overall trading volume.

Following bond dealers, entities grouped as “others” account for the next largest share of the total volume.

This group includes the Bank of Japan, which functions as the agent for JGBs settlement as well as buying and selling a range of debt securities as part of its open market operations.

Nonresident investors also are playing an increasingly large role in the Japanese bond market as a means of investing in yen. They are active players in the short-term JGB market, trading TBs, FBs, T-bills, and others.

Among other categories, city banks (large commercial banks) and trust banks trade large volumes of bonds. Based on their own market view, city banks vigorously engage in bond trading in pursuit of trading profits as well as resell municipal and other bonds underwritten by them.

It should also be noted that trust banks have traditionally allocated large shares of assets under management or administration, including pension assets to bonds.

When measured in terms of net trading volume, almost all business categories have been net buyers of bonds in recent years. Previously, major financial institutions,
including city banks and regional banks, had been large net sellers of bonds because they resold JGBs bought in the primary market.

The “others” category has become a consistent and substantial net seller of bonds because primary JGBs issued by auction are settled via the BOJ and reported as sales by the central bank.

Among other market movements, the continued trend among many business categories to be net buyers of bonds can be attributed to financial institutions’ reduced risk tolerance in their loan portfolios.

This lower appetite for risk has surfaced because of the flight to quality and liquidity of the JGB market in reaction to the depressed stock market and the turmoil in the securitization and commodity markets.
Table §3.02-1. Trends in Bond Transactions by Type of Transaction Parties

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>(billions of yen)</td>
<td>(billions of yen)</td>
<td>(billions of yen)</td>
<td>(billions of yen)</td>
<td>(billions of yen)</td>
<td>(billions of yen)</td>
</tr>
<tr>
<td><strong>City (commercial) banks</strong></td>
<td>15,978</td>
<td>26,523</td>
<td>23,335</td>
<td>17,714</td>
<td>25,102</td>
<td>28,411</td>
</tr>
<tr>
<td></td>
<td>(3,454)</td>
<td>(8,088)</td>
<td>(7,458)</td>
<td>(2,636)</td>
<td>(990)</td>
<td>(2,553)</td>
</tr>
<tr>
<td><strong>Regional banks</strong></td>
<td>2,739</td>
<td>3,037</td>
<td>2,741</td>
<td>2,419</td>
<td>3,624</td>
<td>3,733</td>
</tr>
<tr>
<td></td>
<td>(615)</td>
<td>(841)</td>
<td>(652)</td>
<td>(456)</td>
<td>(604)</td>
<td>(1,002)</td>
</tr>
<tr>
<td><strong>Trust banks</strong></td>
<td>11,611</td>
<td>18,639</td>
<td>19,656</td>
<td>21,287</td>
<td>24,190</td>
<td>20,089</td>
</tr>
<tr>
<td></td>
<td>(1,683)</td>
<td>(4,805)</td>
<td>(4,182)</td>
<td>(4,411)</td>
<td>(4,086)</td>
<td>(3,976)</td>
</tr>
<tr>
<td><strong>Agriculture-related banking institutions</strong></td>
<td>1,997</td>
<td>2,012</td>
<td>2,012</td>
<td>2,698</td>
<td>1,814</td>
<td>2,665</td>
</tr>
<tr>
<td></td>
<td>(686)</td>
<td>(350)</td>
<td>(580)</td>
<td>(178)</td>
<td>(32)</td>
<td>(1,336)</td>
</tr>
<tr>
<td><strong>Other banking institutions</strong></td>
<td>5,839</td>
<td>6,898</td>
<td>5,534</td>
<td>6,801</td>
<td>8,917</td>
<td>7,708</td>
</tr>
<tr>
<td></td>
<td>(1,322)</td>
<td>(3,132)</td>
<td>(2,253)</td>
<td>(2,926)</td>
<td>(3,649)</td>
<td>(3,258)</td>
</tr>
<tr>
<td><strong>Life and property casualty insurance companies</strong></td>
<td>5,512</td>
<td>3,632</td>
<td>3,281</td>
<td>3,574</td>
<td>3,756</td>
<td>4,594</td>
</tr>
<tr>
<td></td>
<td>(1,074)</td>
<td>(871)</td>
<td>(770)</td>
<td>(841)</td>
<td>(941)</td>
<td>(1,234)</td>
</tr>
<tr>
<td><strong>Investment trusts</strong></td>
<td>4,821</td>
<td>3,200</td>
<td>3,265</td>
<td>3,377</td>
<td>3,220</td>
<td>2,920</td>
</tr>
<tr>
<td></td>
<td>(3,107)</td>
<td>(2,034)</td>
<td>(2,398)</td>
<td>(2,271)</td>
<td>(1,978)</td>
<td>(1,498)</td>
</tr>
<tr>
<td><strong>Public employees mutual aid associations</strong></td>
<td>498</td>
<td>876</td>
<td>917</td>
<td>822</td>
<td>786</td>
<td>635</td>
</tr>
<tr>
<td></td>
<td>(−25)</td>
<td>(571)</td>
<td>(591)</td>
<td>(564)</td>
<td>(611)</td>
<td>(459)</td>
</tr>
<tr>
<td><strong>Business corporations</strong></td>
<td>480</td>
<td>950</td>
<td>916</td>
<td>1,216</td>
<td>1,130</td>
<td>1,113</td>
</tr>
<tr>
<td></td>
<td>(341)</td>
<td>(820)</td>
<td>(709)</td>
<td>(1,029)</td>
<td>(966)</td>
<td>(886)</td>
</tr>
<tr>
<td><strong>Nonresident investors</strong></td>
<td>12,948</td>
<td>18,224</td>
<td>20,642</td>
<td>24,860</td>
<td>30,233</td>
<td>28,834</td>
</tr>
<tr>
<td></td>
<td>(2,815)</td>
<td>(3,937)</td>
<td>(3,346)</td>
<td>(5,057)</td>
<td>(5,808)</td>
<td>(8,184)</td>
</tr>
<tr>
<td><strong>Others</strong></td>
<td>22,403</td>
<td>47,589</td>
<td>42,409</td>
<td>45,763</td>
<td>44,845</td>
<td>45,836</td>
</tr>
<tr>
<td></td>
<td>(−15,871)</td>
<td>(−23,832)</td>
<td>(−20,232)</td>
<td>(−21,096)</td>
<td>(−22,043)</td>
<td>(−25,859)</td>
</tr>
<tr>
<td><strong>Bond dealers</strong></td>
<td>118,334</td>
<td>157,488</td>
<td>150,900</td>
<td>174,716</td>
<td>195,292</td>
<td>173,876</td>
</tr>
<tr>
<td></td>
<td>(149)</td>
<td>(−310)</td>
<td>(−298)</td>
<td>(−187)</td>
<td>(−450)</td>
<td>(182)</td>
</tr>
<tr>
<td><strong>Total (including other investors)</strong></td>
<td>206,892</td>
<td>293,559</td>
<td>280,468</td>
<td>308,814</td>
<td>347,880</td>
<td>326,169</td>
</tr>
<tr>
<td></td>
<td>(847)</td>
<td>(2,709)</td>
<td>(4,693)</td>
<td>(948)</td>
<td>(−36)</td>
<td>(1,552)</td>
</tr>
</tbody>
</table>

*Notes:* 1. The figures given in the upper line represent the total of purchases and sales of bonds, and those given in parentheses in the lower line represent the difference between purchases and sales of bonds.
2. Figures exclude those of gensaki transactions.

*Source:* The Japan Securities Dealers Association.
§3.03 OTC Trading of Bonds

The majority of bond transactions take place over the counter (OTC) rather than on exchanges because the secondary market is a dealer-driven market instead of order-driven trading on the stock exchange.

This dealer-driven status is due to the following reasons:

(1) There are so many issues of bonds that it is practically impossible to list all of them on exchanges.

(2) Due to the wide variety of transaction forms and other specifications that different buyers and sellers require, it is difficult to instantly locate a matching counterparty for a particular transaction.

(3) Tax on bond interest varies according to the tax profiles of bondholders; and

(4) Corporate investors, who account for the bulk of the bond trading volume, tend to trade in large lots and often carry out complex transactions involving more than one issue.

On account of these reasons, bond transactions do not lend themselves to trading on exchanges, where the terms of transactions need to be standardized.

Bonds are rather more efficiently traded over the counter, where trades are executed based on the terms individually negotiated between buyers and sellers.

The Tokyo Stock Exchange, the Osaka Securities Exchange, and the Nagoya Stock Exchange have bond trading facilities, but very few issues except for JGBs and convertible bonds are listed there.

The new TOKYO PRO-BOND Market will provide the bond issuers a disclosure and registration (listing) place for bonds and MTNs for professional investors with maintaining the OTC trading environment. (Please see §1.08 [2])

Unlike exchange markets, where all orders for a particular security are concentrated in a single marketplace, OTC trading, in essence, is a decentralized transaction process based on one-to-one negotiation that is conducted over the counter at individual securities companies and banks.
In that sense, it may be said that the counter of each Securities Company or bank is a market in itself and that there are as many OTC markets as there are securities companies and banks.

A wide variety of transactions may be executed over the counter once an investor and participants agree on their terms.

Private placement bonds as well as publicly offered bonds may be traded, and the delivery and settlement procedures are to be agreed upon between the buyer and the seller.

The transaction price can also be decided between the two parties, often in reference to the prices of the relevant financial products.

In OTC trading, a securities company or a bank first buys bonds that a client offers to sell and then resells them to another client afterward.

When a client wants to buy bonds, it sells them out of its inventory or sells short. These types of transactions are generally referred to as “principal transactions.”
Table §3.03-1. Bond Trading by Market

<table>
<thead>
<tr>
<th></th>
<th>Government bonds</th>
<th>Others</th>
</tr>
</thead>
<tbody>
<tr>
<td>FY2004</td>
<td>Exchange</td>
<td>0</td>
</tr>
<tr>
<td></td>
<td>OTC</td>
<td>631,740</td>
</tr>
<tr>
<td>FY2005</td>
<td>Exchange</td>
<td>0</td>
</tr>
<tr>
<td></td>
<td>OTC</td>
<td>690,063</td>
</tr>
<tr>
<td>FY2006</td>
<td>Exchange</td>
<td>0</td>
</tr>
<tr>
<td></td>
<td>OTC</td>
<td>956,614</td>
</tr>
<tr>
<td>FY2007</td>
<td>Exchange</td>
<td>0</td>
</tr>
<tr>
<td></td>
<td>OTC</td>
<td>1,232,317</td>
</tr>
<tr>
<td>FY2008</td>
<td>Exchange</td>
<td>0</td>
</tr>
<tr>
<td></td>
<td>OTC</td>
<td>1,036,070</td>
</tr>
</tbody>
</table>

Note: The figures for exchange trading volume are double those actually reported by exchanges to account for both buy and sell sides of transactions.

Source: The Japan Securities Dealers Association.
Table §3.03-2. Breakdown of Major Bond Categories, by Outstanding Balance and Number of Issues

<table>
<thead>
<tr>
<th></th>
<th>Government bonds</th>
<th>Municipal bonds (public offering)</th>
<th>Government-guaranteed bonds and investment and loan bonds</th>
<th>Straight bonds and asset-backed bonds</th>
<th>Convertible bonds</th>
<th>Band debentures (interest bearing and discount)</th>
</tr>
</thead>
<tbody>
<tr>
<td>End of FY2000</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Number of issues</td>
<td>266</td>
<td>728</td>
<td>504</td>
<td>2,807</td>
<td>711</td>
<td>2,619</td>
</tr>
<tr>
<td>Outstanding balance</td>
<td>367</td>
<td>16</td>
<td>35</td>
<td>50</td>
<td>10</td>
<td>48</td>
</tr>
<tr>
<td>End of FY2004</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Number of issues</td>
<td>313</td>
<td>1,166</td>
<td>807</td>
<td>2,614</td>
<td>159</td>
<td>2,293</td>
</tr>
<tr>
<td>Outstanding balance</td>
<td>620</td>
<td>27</td>
<td>47</td>
<td>52</td>
<td>2</td>
<td>26</td>
</tr>
<tr>
<td>End of FY2005</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Number of issues</td>
<td>332</td>
<td>1,386</td>
<td>925</td>
<td>2,560</td>
<td>110</td>
<td>2,247</td>
</tr>
<tr>
<td>Outstanding balance</td>
<td>666</td>
<td>31</td>
<td>53</td>
<td>52</td>
<td>1</td>
<td>25</td>
</tr>
<tr>
<td>End of FY2006</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Number of issues</td>
<td>357</td>
<td>1,620</td>
<td>1,005</td>
<td>2,500</td>
<td>96</td>
<td>2,143</td>
</tr>
<tr>
<td>Outstanding balance</td>
<td>670</td>
<td>34</td>
<td>54</td>
<td>51</td>
<td>1</td>
<td>22</td>
</tr>
<tr>
<td>End of FY2007</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Number of issues</td>
<td>372</td>
<td>1,836</td>
<td>1,108</td>
<td>2,561</td>
<td>84</td>
<td>1,978</td>
</tr>
<tr>
<td>Outstanding balance</td>
<td>681</td>
<td>37</td>
<td>55</td>
<td>54</td>
<td>1</td>
<td>22</td>
</tr>
<tr>
<td>End of FY2008</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Number of issues</td>
<td>396</td>
<td>2,010</td>
<td>1,200</td>
<td>2,489</td>
<td>55</td>
<td>1,838</td>
</tr>
<tr>
<td>Outstanding balance</td>
<td>676</td>
<td>40</td>
<td>58</td>
<td>56</td>
<td>1</td>
<td>20</td>
</tr>
</tbody>
</table>

*Note: Outstanding balance figures are in trillions of yen.*

*Source: The Japan Securities Dealers Association.*
§3.04 Publication of Reference Statistical Prices for OTC Bond Trading

[1] Historical Background

As OTC bond trading is a negotiated process between a securities company and a client, it is difficult for a third party to discover the price at which a transaction is consummated.

Publication of prices and other information concerning OTC bond transactions not only helps efficient and orderly trading of bonds but is also of critical importance from the standpoint of investor protection by promoting the formation of fair prices and facilitating investors’ access to trading at the best possible price.

Publication of bond prices is thus indispensable for the development of bond markets.

With a view to providing investors, securities companies and others with reference information, the Japan Securities Dealers Association (JSDA) instituted the System for Publishing “Reference Statistical Prices (Yields) for OTC Bond Transactions.”

Under the system, JSDA receives the quotation information from a certain number of designated reporting members (securities companies and banks) and publishes the average price, median price, and highest and lowest prices after excluding certain outliers (each price representing midpoint of ask and bid which the designated reporting members intend to quote) in each issue of publicly offered public sector and corporate bonds that meet certain criteria.

The program was originally instituted in August 1965 by the Bond Underwriters Association of Japan for publishing “OTC Quotes for Industrial Debentures” and was succeeded by the Tokyo Securities Dealers Association, the predecessor of the JSDA, which began the publication of “OTC Quotes for Public and Corporate Bonds” in March 1966.

The initiatives were implemented with a backdrop of social necessity to promote the formation of fair prices and efficient and orderly trading for JGBs, issuance of which had been resumed after the World War II.
The program has since undergone many changes and improvements in response to the changing environment surrounding the bond market.

During that period, the number of published issues has ballooned from about 300 when the system was introduced, to approximately 6,200.

In August 2002, the JSDA changed the name of the data to “reference prices (yields)” from “standard quotes” with the intent to clearly indicate that it is for reference purposes.

At the same time, the program was enhanced by publishing “high, low, and median values of surveyed quotes” in addition to their averages, which was the only data previously published. That system continues today.

The program started publishing bond quotes 40 years ago, and it seems fair to say that it has since made measurable contributions by providing benchmark prices for OTC bond trading in Japan.

The use of data is no longer limited to price references for trading bonds but serves a wide variety of public purposes, including mark to market valuation for financial reporting and tax accounting purposes and the valuation of collateral for different types of transactions.

[2] Improvement of infrastructure for disseminating bond price information

(1) As mentioned above, JSDA manages the system of “Reference Statistical Prices [Yields] for OTC Bond Transactions (hereinafter referred to as the “Reference prices”)” as an infrastructure of corporate bond price information.

These Reference prices are widely used by investors and market participants, and are indispensable infrastructure in the financial and securities markets.

For example, they are used as a reference purchase/sell price of corporate bond, for the fair value appraisal as a pledge, for the calculation of base price of investment trusts, and as a reference price and indicator at the time of determining the issuance conditions for corporate bonds.

(2) However, as the Reference price sometimes diverges from the actual price (such as the execution price and the bid offer) and has a time lag, it is pointed out that we need to review and improve the system.
(3) JSDA and the market participants need to consider the following based on the system in the United States, the United Kingdom and the Republic of Korea to improve the transparency of bond price information and build credibility for the information:

(i) Publication of transaction price
   a. For the time being, JSDA publish the transaction price once a day after the trading hour finishes for issues with high liquidity. As the next stage, JSDA will expand the frequency, timeliness, and coverage based on the transaction volume and other factors;
   b. JSDA will maintain the anonymity of investors (people who made transactions);
   c. JSDA will reduce the cost of securities companies, banks and other users by using an existing system such as the one operated by the Japan Securities Depository Center, Inc. (JASDEC).

(ii) Improvement of credibility of the Reference price
   To improve the credibility of the Reference price, at least JSDA and the market participants will immediately consider the following ideas and implement them.

   a. Review of the designated reporting member system
      · Publicize the name of the designated reporting members;
      · The designated reporting members shall be Association members who are capable of executing the transaction;
      · Others

   b. Putting off the reporting deadline
      · Consider putting off the reporting deadline and the publication timing for the purpose of ensuring the credibility of calculation of the Reference price by the designated reporting members in cooperation with the market participants and users.
   c. Others

JSDA and the market participants will continue to make effort to improve the transparency of bond price information and build credibility for the information.
§3.05 Secondary Market Yields and Terms of Bond Issues

Those who raise funds by issuing bonds look for a method that offers the lowest-possible cost. On the other hand, investors who buy bonds choose issues that offer the highest-possible return at the lowest-possible risk.

In theory, the issue terms of a bond (subscriber’s yield to maturity) are determined at a level where opportunities for arbitraging its subscriber’s yield to maturity and the secondary market yield of outstanding issues of a nature similar to that of the bond are balanced.

When such opportunities are balanced, it is said that “issue terms that adequately reflect the secondary market conditions have been established.”

Important conditions for efficient arbitrage to occur include the following: the outstanding balance and trading volume of comparable bonds are sufficiently large, new bonds are issued regularly, and the secondary market yields of comparable bonds are available for reference at the time of pricing new issues.

This has been demonstrated in the bond market in Japan in that yields at the issue of particular types of bonds have come into line with yields of their comparables as the amount of new issues of the bonds and secondary trading volume of the comparables increased.

[1] Efforts in the government bonds market

More specifically, amid the continued massive issue of government bonds, the proportion of bond issuance through public auctions that more closely reflect market conditions has steadily increased under a market-oriented national debt management policy, replacing the previous emphasis on non-competitive, syndicated underwriting, where issue terms were based on the official discount rate or other benchmarks.

As far as the 10year JGB is concerned, during the long period of time, the syndicated underwriting system, which is non-competitive (conventional) system, has been maintained until the underwriting syndicate system was abolished in 2006.

In contrast, on government bonds of other terms are concerned, over a period of substantial length from before 2006, they have been issued as determined by the tender
Over the considerable long period of time, the market participants and government officials have been making ongoing efforts to realize a fair market price formation.

Currently, in principle, all government bonds are issued through auctions (the syndicated underwriting program for JGBs was discontinued in March 2006).

The market-oriented transition of bond issuance has also been witnessed in pricing spreads among bonds with different credit qualities.

For example, yields at the issue of government-guaranteed bonds and local government bonds were determined in reference to the yield at issue of 10-year JGBs that had been issued earlier in the month.

From time to time in the past, the spreads of issues among these three classes of bonds deviated from market spreads.

In recent years, however, as investors started to focus more on differences in credit quality, the spreads of issues among the three classes have increasingly tended to move more in line with credit spreads prevailing in the market.

Another case in point that demonstrates the increased market orientation in bond issuance is that a growing portion of government-guaranteed bonds is now issued through a competitive bidding process (as individual issues).

Investors are also showing an increasing tendency to differentiate corporate bonds based on credit ratings by rating agencies and other factors.

In response to this, many issuers go through a premarketing process to identify and estimate investors' demand and determine the terms of issue accordingly.

[2] Efforts in the corporate bonds market

For instance, in the corporate bond market, the determination method of the issuing condition has been developed over the past two decades.

(2-1) Proposal method:
In the corporate bond market, proposal method was launched in 1988 based on recommendation by the Securities and Exchange Committee of Ministry of Finance at that time to abolish permanent fixed member syndicate and introduce free competition among securities firms.

In Proposal method, the issuer, taking account of relationship etc to a certain extent, selected a lead manager mainly based on proposed issuing price for issuer’s requesting terms & conditions.

This method worked based on the terms & conditions presented by the issuer.

Accordingly this method had the strong personality of competitive bidding.

The Proposal method, however, soon collapsed because it created intensified competition among securities firms to win the lead manager position and fair pricing was less focused because none of issuer or investor could confirm fair pricing due to undeveloped and illiquid secondary market conditions.

Trustworthiness and confidence on pricing offered by the lead manager was to cause serious doubts in all the cases.

(2-2) Negotiated method:

In 1991, Nippon Telegram and Telephone (NTT) dropped the proposal method and introduced new method to appoint lead manager(s);

JGB spread pricing based Fixed Price Reoffer with Syndicate break for launching and pricing new issue under Negotiated method to seek for fair pricing even under undeveloped and illiquid secondary market.

In new Negotiated method, NTT has not requested pricing indication to any securities firm since then.

Instead they put heavy weight on proposal of new issue strategy and commitment on secondary market maintenance in selection of lead manager(s).

As for new issue pricing they emphasize discreet price discovery and decent book building process after mandating lead manager(s).

In this new scheme, it aims fair pricing to reflect the accurate investors’ demands under prevailing market. For the purpose JGB Spread talk with investors was introduced as the benchmark to find out appropriate price to clear target issue amounts.

And, then, corporate bond issue shifted to flat sales price system.

After several years, Utilities companies, the general business companies and some
public sector entities adopted the similar scheme.

This method cannot be allowed to discount sales: the sales prices reflect the prevailing market conditions.

Since then, many issuers, for realizing the fairer market pricing, have been trying various methods.
§3.06 Repurchase (Gensaki) Market for Bonds

A repurchase agreement (a conditional purchase or sale) is a form of trading between a seller and a buyer of debt securities whereby the seller (or the buyer) agrees to repurchase (or resell) the securities at an agreed-upon price at a stated time.

When the holder of bonds sells them to a buyer under an agreement to buy them back (a gensaki sell transaction), the holder can raise funds temporarily.

When an investor buys bonds from a seller under a repurchase agreement to sell them back to the seller (a gensaki buy transaction), the investor can earn a certain amount of interest by investing funds for a short period.

When a securities company acts as an intermediary and arranges a repurchase agreement by introducing a buyer who wants to invest idle cash in bonds to a seller who wants to raise funds by selling bond holdings, such a deal is called a brokered repurchase agreement.

When a securities company that is in need of short-term cash sells bonds out of its inventory to an investor under a repurchase agreement, it is called a proprietary repurchase agreement.

As the repurchase (or resale) price includes an amount equivalent to a return on investment or financing charge based on an agreement by the buyer and seller, the price does not usually tally with the market price of the bond prevailing at the time of its repurchase (or resale). Repurchase agreements can also be concluded for commercial paper (CP) and certificates of deposit (CDs) and CPs issued overseas.

As gensaki transactions conveniently meet the short-term funding and cash management needs of investors, their trading volume has increased steadily.

The outstanding balance of gensaki transactions reached almost ¥27 trillion ($300 billion) at the end of fiscal 2000, compared with ¥7 trillion ($77.7 billion) in the late 1980s. Although there have been some dips in the balance since then due to an accommodative monetary policy, the balance has grown overall, partially because of the massive issuance of JGBs.
Along with the BOJ’s lifting of quantitative easing measures and other factors, the balance reached ¥50 trillion ($555.5 billion) at the end of fiscal 2007.

Previously, the overwhelming majority of gensaki transactions were for short-term government securities (TBs, FBs, and T-bills). Despite intensifying competition against other increasingly diversified money market instruments these government bills have dominated the gensaki market, as the bills, which have maturities and credit quality more suitable for gensaki transactions, have been increasingly issued to the public.

Although the gensaki market developed against the backdrop of this expansion of the short-term government securities market, interest-bearing JGBs have taken center stage in recent years, partially because of the massive overall issuance of government bonds.

In an effort to modernize and strengthen the international competitiveness of Japan’s money market, the gensaki market underwent a reform to improve its functions as a repo market that facilitates the need for both short-term financing and bond borrowing, and thus what came to be called new gensaki transactions started in April 2001.

Up to that point, gensaki transactions were bought and sold much like the transactions commonly known as repo trades in the U.S. and Europe but had various shortcomings that cried out for reform.

In particular, the gensaki market did not have functional risk management facilities or standard rules for dealing with counterparty default.

By this reform, new measures were instituted and existing provisions were enhanced for risk management and other purposes, establishing the gensaki market in accordance with global standards.

The newly introduced provisions for risk management and other purposes (clauses in the repurchase agreement) may be summed up as follows:

(1) Risk control clause
The amount of collateral (bonds) shall be adjusted flexibly so as not to cause a
shortage of collateral on account of a fall in the price of bonds submitted as collateral.

1) The application of the ratio for computing the purchase/sale value of bonds (the haircut clause)

Under this clause, the unit price of bonds (collateral), on the basis of which a repurchase agreement is concluded is fixed at a level that is a certain percentage point lower than the price prevailing at the time the repurchase agreement is concluded, so that the value of the collateral will not be affected even when the market price of the underlying bonds falls.

2) The introduction of management of collateral, etc. (the margin call clause)

Under this clause, when the market value of the underlying bonds changes during the period of the repurchase agreement, the amount of credit extended to a party to the repurchase agreement is maintained by adjusting the collateral.

3) The introduction of the repricing system

In a case in which the market price of the underlying bonds falls sharply from that which prevailed at the time of the repurchase agreement, the parties to the agreement agree to cancel the agreement and renegotiate a new agreement on the basis of a price then prevailing, on terms and conditions identical to those of the agreement thus canceled.

(2) Substitution of underlying bonds

Under this clause, the seller of bonds can replace the underlying bonds with other bonds with the consent of the buyer, allowing the seller to use the underlying bonds if necessary.

(3) Institution of netting-out system

If the other party goes into default for any reason, such as bankruptcy, the value of all transactions covered by the agreement will be reassessed based on market prices, and the difference between claims and obligations will be settled.
§3.07 Bond Lending

When investors have shorted bonds (or sold bonds that they do not own) and failed to buy them back before the settlement date, they turn to bond lending services to borrow bonds to deliver. Such transactions are also known as saiken repo (bond repos) in Japan.

When cash is used as collateral, bond lending is economically equivalent to gensaki transactions. Since market participants can obtain bonds through bond lending facilities after trades are consummated, they can sell bonds that they do not own (sell short) when they feel that the bond market is too expensive or particular issues are overvalued. Such operations contribute to greater liquidity in the market.

Bond lending was instituted by legislation in 1989, following the lifting of the practical ban on bond short selling. In fear of potential effects on the financial health of brokers and dealers and bond pricing, market participants had previously been requested to refrain from selling bonds short.

The ban, however, was lifted to help encourage active market making in cash bonds, and arbitrage between cash bonds and futures and bond borrowing and lending was introduced as one of the means to locate bonds to deliver.

Initially, cash collateral bond borrowing and lending was restricted in light of potential conflicts with the gensaki market and other considerations, and, subsequently, most transactions were uncollateralized.

However, with credit fears rising, the bond lending market remained stagnant and cash collateral bond borrowing and lending transactions were effectively deregulated in 1996 in order to invigorate the market.

When viewed from a legal standpoint, a bond lending transaction is deemed to be a “contract for a loan for consumption.” i.e. A borrower borrows bonds for the purpose of consumption and, when due, the borrower has only to return bonds identical in kind and quantity with those originally borrowed.

Bond lending transactions may be broadly classified into “unsecured transactions” and “secured transactions” depending on whether they are collateralized or not.
Secured bond lending transactions may be further divided into “cash-collateralized transactions” and “securities-collateralized transactions” by the type of collateral being pledged.

Cash-collateralized transactions used to borrow specific bond issues are called SC torihiki (specified collateral trades), while those for financing and cash management without such specification are termed GC torihiki (general collateral trades).

The size of the bond lending market (in terms of the balance of outstanding loans) has generally been growing since cash-collateralized transactions were deregulated in 1996. The market has grown from approximately ¥30 trillion ($333.3 billion) at the end of fiscal 1996 (including approximately ¥17 trillion in cash-collateralized transactions) to ¥106 trillion ($1,177.7 billion) at the end of fiscal 2008 (including approximately ¥97 trillion in cash-collateralized transactions).

The majority of bond lending transactions are conducted with government securities.
§3.08 PTS for Fixed Income Securities

[1] Overview

The revision of the Securities Exchange Law in December 1998 led to the birth of PTS (Proprietary Trading System). FSA announced the PTS guidelines in November 2000. According to the guidelines, although PTS operators are highly regulated by FSA and required to obtain an approval for PTS license, some entrepreneurs and innovators have launched the electronic trading systems. Unlike stock trading, as bonds are traded mostly OTC (Over the Counter), the needs for improving the transparency, efficiency and accuracy in trading have been strong. It became stronger in the past several years due to the increase in compliance/governance requirement. PTS was supposed to be ideal to enhance the governance in trading. In reality, however in Japan, PTS has not been very successful and it has a long way to go.

[2] IDB and B-to-C market

There are 2 types of PTS operators: One is B-to-B (IDB market) and the other is B-to-C (institutional investor market).

IDB market adopted the PTS rather soon. Main operator is a mighty BB(Nihon Sogo Shoken) and ICapTotan, Central Tanshi follow. BB has been aggressive in E-trading and its PTS operation is highly successful. Other brokers have been laggard, far behind BB. It is estimated that BB trades 80% of the trade through PTS.

B-to-C market has developed totally differently. There have been two main players in this market. JBOND was founded in April 2000. It started the operation in June 2001 as a quotes-comparison site. Eventually JBOND became a securities company in September 2002 and received PTS license in October 2002. Since then, the company operated JGB PTS by adding market makers and institutional investors slowly. Yensai.com was founded in January 2001 by seven major securities dealers following the business model of TradeWeb. It received the PTS license in March 2002.

TradeWeb, a dominant player in the U.S. and Europe was rather slow to enter Japanese market. It received the PTS license in 2005 to trade foreign bonds. Japanese bonds trading was added as late as 2008. Bloomberg also has a PTS license but its system is a gateway to lead an inquiry into a certain dealer/broker and it is not
regarded as a fully fledged multi-dealer system provider.

FSA has encouraged asset management companies to adopt a trader-system, where traders concentrate in trading and fund managers focus on portfolio management.

These FSA guidelines encouraged traders use e-trading more often. At the same time, due to the increased compliance needs, investment management companies with fiduciary responsibility have been required to obtain several quotes before a trade is done to ensure the best executions. Thanks to these developments, investors have started showing the interest in PTS platforms gradually.

Still, the combined share of all the PTS players is estimated less than 5% in the JGB wholesale market. JGB PTS market is negligible in terms of trade volume.

**IDB vs B-to-C market**: As mentioned above, E-trading has grown in the IDB market in a short time period but B-to-C market has been very slow. The reason for this is not clear but some people tried to explain by the difference in trading attitude. Market makers want to know why investors are selling or buying in order to see where the market is heading. One of the bond salespeople’s important responsibilities is to find out the investors thinking / behavior. Thus they call investors incessantly and provide the information back to dealers. According to this information, dealers build up their positions. On the other hand, IDB market is the place for squaring positions. Brokers’ task is to match the trades. Therefore, telephone conversation is not so important in the IDB market. As brokers do not lose much by switching to e-trading they did not resist the change much.

**B-to-Retail Market**

Daiwa Securities announced the new service in April 2010: “PTS online trading service for JGBs issued for personal investors”. If you want to sell 10 year FRN JGBs, you must pay some cancelation fee and a buyer has to pay accrued interest. Daiwa PTS matches the buyers and sellers and eliminated the extra fees. The market volume and activities level are not known. As the demand for FRN JGBs is very low, it could be assumed that the market is not very active.

**[3] Pricing Method**

FSA’s guidance provides 5 pricing method; they are

1. Market Price Trading Method = use current prices and quotes on the stock
exchanges

(2) Direct Negotiation Method  =  use a price negotiated between customers
(3) Order Matching Method  =  orders from customers are matched with each other
(4) Quote Driven Method = market makers show their quotes and stand ready to trade with customers
(5) Auction Method

For bonds PTS only (2), (3) and (4) are applicable:

(2) Direct Negotiation Method

It is often called as “negotiation method” and sellers and buyers negotiate the price, volume, settlement date and other conditions. As this method is similar to the way bonds are traded over the phone, all the PTS operators in B-to-C market have adopted this method.

(3) Order Matching Method

A trade is done when an order from a buyer and a seller is matched. PTS operators provide the screen where buyers and sellers put up their orders. Counterparties who wish to trade will click orders and trades are done. As the monitor screens are similar to the ones that inter dealer brokers use, IDB PTS operators use this method. JBOND Repo System also adopted this method.

(4) Quote Driven Method

It is often called market making method. Market makers show their bids and offers for bonds they wish to trade. Market makers are not obliged to show the quotes for all the bonds and in case of Yensai.com, securities dealers must confirm the trade before it is done. Therefore, this click and trade quote driven method did not get popular among institutional investors.

[4] Players

Yensai.com was founded by 7 major securities dealers in 2001. It differentiated from other PTS players with major Japanese market makers. It provides two types of trading method: One is real time order system (a quote-driven system), and the other is inquiry system (an order-driven system). Real time order system shows all the bids and offers for JGBs with tradable amounts on the side. This click-and-trade system looked handy and attractive. But in reality, the usage has been pretty limited. Most users look at the
monitor screen just to find out the current yield curve, not to do trades. As securities dealers did not feed the best prices, investors used the bid/offer prices as indication. The order-driven system has been relatively successful. Currently, there are 10 securities dealers participating and they make market for all the interest bearing JGBs.

Founded in January 2001
PTS operation started in 2002
Market makers:
- Daiwa Securities Capital Markets
- Citigroup Global Markets Japan
- Nomura Securities
- Deutsche Securities
- Mizuho Securities
- Barclays Capital Japan
- BNP Paribas Securities (Japan)
- Nikko Cordial Securities
- RBS Securities Japan

**JBOND**, another PTS operator was founded in 2000 and started the service before Yensai.com. Although it received high recognition with its innovative, user-friendliness, due to the lack of liquidity, it did not dominate the market. Its Participating market makers were mainly foreign banks as Yensai.com discouraged strongly its market makers/shareholders to participate in the other platforms.

Founded in April 2002
PTS operation started in November 2002
Repo PTS started in October 2009
Market makers (as of June 2010 for JGBs trading system):
- Barclays Capital Japan
- Cerdit Agricole
- Credit Suisse
- Deutsche Securities
- JPMorgan
- Tokai Tokyo Securities
- SMBC Friend Securities
- Tokyo Tanshi

**JBOND** has shifted the focus from JGB outright trades to JGB Repo market June
2010. JBOND is the first and only PTS player for Repo E-trading. Its users are limited to JGBCC (Japan Government Bond Clearing Corporation) members. It is too soon to tell if it would take off in Japan. BB runs the similar system but it does not operate as PTS.

TradeWeb, a dominant player in the U.S. and Europe, was rather slow to enter Japanese market. It received the PTS license in 2005 and started trading Japanese bonds in 2008. About 10 broker/dealers are participating but the activities are rather limited. Bloomberg also has a PTS license but its system is a gateway to lead an inquiry into a certain dealer/broker. It does not have significant influence in the market.

Founded in 2004 in Japan

PTS operation started in 2005 (for JGBs in 2008)

Market makers (guess)
Barclays Capital Japan
Citigroup Global Markets Japan
Credit Suisse
Deutsche Securities
JPMorgan
RBS Securities
UBS Securities
and others
Questionnaire 4: Possible item of Impediments / Restrictions for the realization of a cross-border inter-regional market

(The following items are just for the reference)

■ Possible Item of Impediments / Restrictions
  ✓ Taxation (Withholding Tax on Interest Income, Stamp Duty, Tax Report Requirement, etc.)
  ✓ Disclosure & Investor Protection Rules for Issuers
  ✓ Underwriting Rules for Financial institutions
  ✓ Impediments for Timely issuance (suspension period, disclosure requirements, etc.)
  ✓ Restriction of Investors (qualified institutional investors, private placement)
  ✓ Registration Requirement for Foreign Investors
  ✓ Reporting requirements (non-resident trade report, foreign currency denominated instruments etc.)
  ✓ Non-resident requirements (identification requirement, restricted stocks, etc.)
  ✓ Restrictions on OTC Transactions by Residents
  ✓ Restrictions on OTC Transactions by Non-residents
  ✓ Credit Rating System and its relation to Regulations
  ✓ Utilization of Shelf-Registration System / MTN
  ✓ Prohibition on the Use of Omnibus Accounts for Settlement of Securities Transactions
  ✓ Availability of Information in English
  ✓ Restrictions in Accounting Standard
  ✓ Limited Opportunities to Utilize Bond Holdings / Repo Market
  ✓ Degree of Lack of Liquidity in the Secondary Market
  ✓ Others
Answer 4

§4.01 Current Japanese Market Situation

[1] Tide for the Change

Fortunately, in the past several years the impediments isolating the domestic market from foreign markets have been removed in Japan through the efforts of policymakers and market participants.

In 2008, the Financial Services Agency (FSA) revised the Financial Instruments and Exchange Act (FIEA) as part of its plan to enhance the competitiveness of Japan’s financial and capital markets, establishing the legal framework for markets oriented towards professional investors (a private offering system for designated investors and designated financial instrument exchange markets).

This provided the legal framework for the establishment of a new securities market as mentioned in §1.08, one not predicated on legal disclosure, corresponding to the U.S. Rule 144A market.

In addition, the taxation system was reformed in fiscal 2010 to reduce the tax on revenues from domestic corporate bonds held by non-residents to zero.

Here we are seeing the opportunity to put an end to the state of isolation of Japan’s domestic markets.

Having done away with these twin constraints in the legal and taxation systems that have conceptually separated domestic bonds from Eurobonds and other international bonds in Japan, if appropriate rules are provided for disclosure and registration (listing) in the near future as mentioned §1.08, the necessity for separating domestic and international bonds will decline, and the Japanese market participants will witness a radical improvement in the mobility and the convenience of the Japanese corporate bond market.

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(1) Going through various system reforms, the corporate bond market in Japan has developed as a free and efficient market and has played an important role in corporate financing.

After the global financial crisis in 2008, the market has shown steady recovery, and the issuance of corporate bonds, mainly by high-rated companies, increased by 2,550 billion yen to 11,390 billion yen in 2009 from the previous year (+29%).

(2) However, comparing the Japanese corporate bond market with those in the United States and Europe (i.e., Euromarket), corporate bond issuance is not as robust, with an outstanding amount as of the end of December 2009 of only 59,450 billion yen, approximately one-tenth that of the U.S. market.

Looking at the ratio of outstanding amount to GDP, Japan’s ratio is an extremely low 13% compared with 48% in the United States; we see the same comparative trend in the Europe market (Euromarket).

Additionally, the importance of corporate bonds as a fund management tool is significantly lower in Japan compared with the United States and Europe. Clearly, the Japanese corporate bond market remains a small market compared with the U.S. and European markets.

(3) Although various types of companies actively issue corporate bonds in the U.S. and Europe (Euromarket), the issuance of corporate bonds in Japan is still limited to fairly high-rated companies in specific sectors.

Looking at corporate bond holdings in Japan, the main holders are banks (depository institutions) with individual investors, investment trusts, and foreign investors being relatively minor players.

(4) Furthermore, as many investors hold corporate bonds until redemption in Japan, the liquidity of corporate bonds is low and the secondary market is small.

(5) As indicated below, there are many complex factors behind the small size of the corporate bond market in Japan.

Although there are some factors that cannot be overcome easily, it is believed that there are many other factors that can be prevailed over with the steady efforts of market participants and the relevant government agencies.

Market participants need to correctly recognize and make efforts to overcome these factors.
It is believed that vitalization of the corporate bond market will promote the diversification and decentralization of financing methods by private companies as well as the expansion of asset management opportunities for investors, leading to strengthening of the financial and capital markets.

This in turn will result in the active and steady development of the Japanese economy.

To this end, the market participants need to take measures to vitalize the corporate bond market in their daily business and establish a solid and liquid market.

Since the 2008 global financial crisis, vitalization of the corporate bond market has become a particularly important and urgent issue. At the onset of the financial crisis, the short-term money market became extremely tight and many companies shifted to bank loans.

In some cases, it was difficult to borrow money from banks, and new and rollover issuance conditions were very unfavorable in the corporate bond market. In light of these circumstances, private corporations clearly recognized the need to diversify their financing methods and the sources of funds.

Similarly, it has become increasingly essential to develop a corporate bond market with high transparency and liquidity that enables steady financing of large amounts of money on a long-term basis.

Because strengthening the equity capital of banks and other financial institutions has become a major issue of global financial regulatory reform following the financial crisis, it is believed that banks' loan activities will change accordingly.

It is expected that improving the corporate bond market function within a new regulatory environment will result in the proper development of financing mechanisms, including bank loans, and contribute to the advancement, enhancement, and stability of Japan’s financial and capital markets. Development of the TOKYO PRO-BOND market is in line with this movement.

Furthermore, developing the infrastructure of the corporate bond market in Japan and creating a more efficient corporate bond market with higher transparency and liquidity will increase the participation of foreign issuing corporations and investors including those from Asian region.

It will also help the Japanese financial and capital markets play a role
suitable for the economic scale of Japan in the global market.

Building a market that is useful for such professional investors as institutional investors will contribute to improving the diversity of corporate bond issuers, market usability, and diversification of asset management methods for investors, as well as enable Japanese market layers to utilize human resources and information-analysis skills held by Japanese financial institutions and market participants for corporate bond issuance and financing by Asian and other foreign companies.

It will also assist the Japanese capital market in playing an important role as a main market, internationally and in Asian region.


(1) The Japanese corporate bond market has developed its flexibility and efficiency through system reforms such as the abolishment of regulations on corporate bond issuance limits and revision of the trustee company system (1993), the abolishment of grade criteria for corporate bond issuance and deregulation of bond covenants (1996), and the electronic registration of corporate bond certificates (2006). The credibility of corporate financial reporting has been boosted by developing accounting standards and enhancing the audit system. The above actions have also increased the attractiveness of corporate bonds as financial instruments among investors. Because many companies recently have issued corporate bonds targeting individual investors, corporate bonds are also becoming an attractive investment instrument for individual investors.

(2) On the other hand, in spite of the system reforms mentioned above, the corporate bond market in Japan is still small. As has been pointed out, the background to this situation lies in the complex interaction of various factors such as those indicated below:

(i) Looking at the flow of funds in Japan, while the public sector is significantly short of funds, private non-financial corporations tend to have a surplus of funds. Particularly, in a situation where economic growth is slow and capital investment is restrained, the demand for long-term funds has been sluggish and many companies have issued corporate bonds not to raise new long-term
funds but to roll over their existing long-term borrowings.

(ii) In an environment marked by low corporate finance demand, because of the government’s active supportive measures and financial policies to help private corporations and intensifying loan competition among financial institutions, including banks, (see (iii) below for details), private corporations have been able to finance themselves at lower cost with bank loans rather than corporate bond issuance for a long period of time.

(iii) The “Chicken or the Egg” problem; i.e., the inactive issuance of corporate bonds results in and is caused by the low liquidity of corporate bonds, has yet to be solved. Consequently, the liquidity of corporate bonds remains low, and as a result, conditions in the secondary market have not been properly reflected in the primary market in a timely manner. Additionally, although we need to improve the transparency of corporate bond prices in the secondary market, the Reference Statistical Prices [Yields] for OTC Bond Transactions published by JSDA are not sufficiently reliable to serve the role of properly reflecting secondary market conditions. Furthermore, we have not developed a settlement and clearing system and a corporate bond repo market that can contribute to stimulating the secondary market.

(iv) Due to corporate bond underwriting practices, flexible issuance in accordance with needs is difficult because the issuable period of corporate bond is limited and the issue timing is concentrated. Corporate bond issuance procedures are not flexible and agile because the roles and responsibility sharing among securities companies conducting underwriting examinations (Type I Financial Instruments Business Operators), issuer, audit corporation, and certified public accountant have not been defined and the handling rules for comfort letter have not been clarified. Furthermore, the pot system, which is popular in the U.S. and Europe as a standard method of determining the conditions of issuance, has not been established in Japan, and as a result, the conditions of issuance cannot be quickly set.

(v) Due to the small size of the corporate bond market in Japan, some Japanese institutional investors have not established an adequate research system nor fostered sufficient analysts to conduct a credit analysis of corporations, a mid- to long-term issue in the market. Moreover, when investing in a corporate bond, investors in some cases significantly rely on external rating agencies, and tend to adopt a similar investment strategy to those adopted by other institutional investors. Individual investors have difficulty
obtaining information on corporate bonds.

(vi) There was no sufficient tax exemption system for investment in corporate bonds by non-residential investors until June 2010, when such a system was introduced to promote investment in and holding of corporate bonds by foreign investors. Consequently, up to now, the corporate bond market was not a good place to actively invest in for investors with a higher risk appetite.

(vii) Defaults by issuing companies have been very rare in Japan. Therefore, we have not accumulated sufficient data on the relationship between the credit risk of the issuers and issuance conditions.

(viii) In many cases, a negative pledge giving all corporate bonds the same priority is attached to a corporate bond. As a result, when the issuer is in default, there is a concern that the rights of corporate bond holders will be subordinate to the rights of other creditors. As the covenants that are also attached to debts other than the corporate bonds are not fully disclosed, the preferred or deferred relationship between corporate bonds and other debts is unclear. This point should be improved from the perspective of investor protection.

(ix) In an investment environment where there have been very few corporate bond defaults corporate bond administrators have not been appointed in many cases except for corporate bonds targeting individual investors. Therefore, there is no consensus about the role of a corporate bond administrator and the preservation attachment for corporate bond holders when the corporate bond is in default, and no discussion has been held regarding cost sharing.

(x) As laws and regulations, the concept of bankruptcy, and the role of financial institution in the corporate reconstruction process in Japan are different from those in the United States and Europe, many people in Japan believe that only companies that have a certain level of credit strength can issue corporate bonds.

(xi) There remain taxation complexities in the market, such as different tax treatments depending on the type of assigner of a corporate bond. This is one of the factors that impedes higher liquidity for corporate bonds.

(3) One of the reasons why the corporate financing structure in Japan relies heavily on bank loans rather than corporate bond issuance is that the risk premium of bank loans is lower than that of corporate bonds due to the reasons listed from
(i) to (iii) below. Therefore, the funding cost of borrowing is cheaper than that of corporate bond issuance. If an appropriate spread could be set that reflects the credit risk, market liquidity, and the handling of pledges regardless of bank loans or corporate bonds, corporate bonds would become more attractive for issuers of corporate bonds as well as for investors, contributing to the diversification of financing methods for corporations and the variety of investment instruments for investors. While it is pointed out that setting an appropriate risk premium on bank loans is an important issue for the financial system in Japan, it is necessary to reduce the risk premium gap between bank loans and corporate bonds by improving the efficiency, transparency, and liquidity of the corporate bond market. This issue needs to be solved by both market participants and banks by tackling their own issues one by one based on their individual viewpoints as well as through cooperation with each other in establishing more transparent and sound market practices.

(i) In circumstances where companies have less demand for funds because of the sluggish economy, banks have made transactions with borrowers from a mid- and long-term viewpoint and/or under a comprehensive service scheme, including settlements and foreign exchange. Due to the public supportive measures and financial policy and intensifying lending competition among banks, lenders cannot set loan interest rates that are appropriate for the real credit risk of the borrower. We have to carefully analyze and determine how to evaluate the compensation gained by banks that provide comprehensive financial services and the long-term credit risk involved, and how to compare the cost of corporate bond issuance based on liquidity.

(ii) Banks lend money based on detailed information such as the pledge provided by a borrower company and the short-term funding requirements of the borrower, while the issuance of and the investment in corporate bonds are based on disclosed information such as timely disclosure by securities exchanges, prospectuses, and securities reports. In this manner, banks obtain a broader and more detailed range of information that seems to affect their loan conditions. We need to consider how the market evaluates and determines the above facts.

(iii) Financial institutions such as banks have taken provisional measures through the management of pledges provided by borrowers before executing loans. Also, when the borrower falls into management difficulties, banks not
only preserve and recover the debts, but in some cases also play a certain role in the insolvency, reorganization, or reconstruction process of the borrower. The higher risk premium for corporate bonds may partly be due to the possibility of having to take these actions on behalf of corporate bond holders if the issuer defaults.

(4) Corporate bonds are more specific in nature than shares, and their issuing conditions vary in each case. A syndicate loan is also an agile funding method with high liquidity that is similar to a corporate bond. To vitalize the corporate bond market, we need to develop infrastructure taking into consideration the similarity of corporate bonds to syndicate loans.

(5) Credit default swap (CDS) transactions have recently increased in the United States and European markets, with some large-sized companies in Japan also actively conducting CDS transactions. We need to promote the sound development of CDS transactions and the CDS market in Japan, as it supplements the liquidity of the corporate bond market. We also need to carefully monitor the relationship between the CDS market and the corporate bond market.

(6) As a result of the fiscal crisis, some developed countries have recently run up huge financial deficits, focusing attention on the purchase levels and the secondary market prices of government bonds in capital markets. Therefore, we need to keep a close eye on how trends in the government bond market affect the corporate bond market.
§4.02 Reducing the Blackout Period & Expansion of Funding Sources

- The professional securities market as shown in §1.08 will increase the convenience for Japanese and Asian issuers and holders of corporate bonds by reducing the blackout period in Japan, simplifying or omitting issuance procedures, omitting procedures in the secondary market, and reducing procurement-related costs, including disclosure costs.

  ⇒ Establishment of public issue market for professional investors that eschews the legal disclosure requirements applied to retail investors.

- Expansion and diversification of funding sources (greater distribution of debt portfolios)

  ⇒ A professional issuing market employing English-language disclosure can be created, increasing convenience for overseas issuers. In addition, by adding Eurobonds and a Euro MTN Programme to the PSM·J eligibility requirements on the Japanese stock exchange, we will create a Euro Asia offerings market similar to the U.S. Rule 144A option.

  ⇒ By limiting market participants to institutional investors and other professionals, it will be possible to ease the obligation of disclosure for issuing companies, and thus expand opportunities for funding for Japanese and regional issuers.
§4.03 Inconvenience of Current Disclosure System for Public Offering

- Many of the Japanese corporate bond issuers are having critical views that:
  - The Japanese public offering market for domestic corporate bond has been subjected to the strict disclosure requirements which have originally been designed for the Japanese retail investors.
  - But in reality most of bonds issued have been purchased by the professional investors.
  - On the other hand, existing private placement markets in Japan are not easy to use for issuers and investors. They have no secondary market.
  - As a result, due to strict restrictions, the chance and the period that issuers can make quick and timely issuance of corporate bonds in the Japanese domestic market are extremely limited through the year in comparison to the Eurobond market.

- Domestic securities-related regulations for retail investors, such as legal disclosure regulations, will not apply in the new TOKYO PRO-BOND Market.
- By excluding ordinary and amateur investors such as private individuals and catering exclusively to professional investors (institutional investors, etc.), this new market will be able to waive the legal obligation of disclosure applied to retail investors.
§4.04 Due Diligence by Securities Companies

- Necessity of the review of Due Diligence (underwriting examination) by securities companies in Primary Market

(1) Issuers pointed out the following regarding the due diligence conducted by securities companies and ensuring the flexibility of corporate bond issuance:

- Listed companies are required to comply with the quarterly disclosure, internal control reporting, and confirmation document requirements under the Financial Instruments Exchange Act (hereinafter referred to as the “FIEA”) for the purpose of ensuring timely disclosure of financial and corporate information, and are subject to an audit and review by a certified public accountant or audit corporation. Given that the financial statements are prepared using such a comprehensive quality control system, securities companies should simplify and adopt a flexible process for the due diligence.

- Currently, companies tend to avoid the issuance of corporate bonds during periods when a quarterly report needs to be submitted between the determination of corporate bond issuance conditions and payment for the bonds. Securities companies also are generally conservative in their due diligence even after the submission of a quarterly report. These attitudes limit and concentrate the issuable period for corporate bonds and thus impede flexible issuance.

(2) The market players understand that securities companies need to conduct a certain level of checking in their due diligence to protect investors. However, to simplify and flexibly carry out the underwriting examination, it is necessary to clarify the policy under the FIEA on how to share the responsibilities in the case an error is found in the financial information of a prospectus, and to fully disseminate such a policy to the relevant people.

(3) To promote flexible issuance of corporate bonds and reducing compliance costs, the market players need to discuss the following items, review the due diligence process by securities companies, and find a way to cease the above mentioned market practices concerning underwriting examinations:

- Due diligence scheme of securities companies;
- Roles and handling of comfort letter;
- Principles to clearly share responsibilities under the FIEA and full
dissemination of them.
§4.05 Determination Process for Corporate Bond Issuance Conditions

- Establishment of rational determination process for corporate bond issuance conditions is necessary.

(1) While securities companies conduct a bond demand estimate survey in the process of determining conditions of issuance, the resultant conditions do not necessarily reflect market conditions, due to duplicated or false demands. It is pointed out that this is one of the factors that triggers “sale at a discount” (sale under conditions inferior to the conditions of issuance) of corporate bonds in the secondary market.

(2) For instance, in the U.S. the so-called “pot system” is commonly used for the determination of corporate bond issuance conditions. The “system” eliminates the duplicated or false investor demand and increases the transparency of the conditions determination process. It also standardizes the corporate bond issuance procedure and shortens the period required for issuance, resulting in smoother issuance of corporate bonds.

(3) The market players have seen some corporate bond issuances that used the pot system in Japan. The market players will believe that it is necessary for market participants to establish a guideline as necessary in order to share common views on practical issues such as thorough control of client data by securities companies and find a solution as soon as possible for the purpose of establishment of rational determination process for corporate bond issuance conditions.

Introducing of the pot system in Japan may be one of the options. In any case, careful examination is required.
§4.06 Measures to Cope with Default Risk

For vitalization of the corporate bond market, it is necessary to develop and construct a lower-rated corporate bond market that enables not only high-rated issuers but also corporations with relatively higher credit risk to use the corporate bond market. JSDA and the market participants plan to develop the following measures that will protect investors when business conditions deteriorate at issuing companies or companies default on their corporate bonds, for the purpose of expanding the investment in corporate bonds issued by companies with relatively higher credit risk.

[1] 4.06.01 Granting of covenants and information disclosure

(1) Granting of covenants

✓ Since the abolishment of grade criteria and deregulation of the financial special contract in 1996, issuers can flexibly grant covenants on corporate bonds issued in and after 1996 reflecting the financial condition of the issuer. JSDA believe that such a flexible scheme should be maintained and enhanced in the future for vitalization of the corporate bond market.

✓ On the other hand, currently, the covenants granted on a corporate bond issue mainly cover the negative pledge clause (a clause prohibiting the issuer from creating any security interest over certain property specified in the provision) and cross acceleration.

✓ While the negative pledge clause is a special agreement for the purpose of protecting investors that prohibits the issuer from creating a security interest over other non-secured debts, it is usually effective only among corporate bonds. In 2009, only two corporate bonds targeting individual investors had covenants covering other debts and loans.

On the other hand, in loans, a certain preservation measure is generally taken in response to the condition of the debtor at the time of executing the loan. In this regard, a corporate bond that was issued before the loan is likely to defer to other debts and loans from a property preservation viewpoint. Therefore, it has been pointed out that theoretically the granted covenants may affect the recovery of debt in the case of a corporate bond default by a company with relatively higher risk.
In future, when JSDA and the market participants promote expanding issuance of and investment in corporate bonds issued by corporations with relatively higher credit risk, it will be necessary to develop an environment where various kinds of covenants can be granted flexibly to reflect the capital and financial policies of the issuer and to meet the needs of investors, with such covenants being fully reflected in the issuance conditions for corporate bonds. Having said that difficulty exists in the case that the bond issuer disliked the covenants to avoid the issue.

For this purpose, take into consideration of the examples in the United States, JSDA and the market participants need to prepare and illustrate by example a model of standard covenants for corporate bonds issued by corporations with relatively higher credit risk, for use as a reference by issuers, investors, and securities companies. It will also be necessary to disseminate market practices that enable us to grant flexible covenants and determine reasonable issuance conditions. But, in Japan, as a general practice, the secured bank loans system has been established, it may be difficult to introduce the US system directly.

Among the issues, JSDA and the market participants should address in future regarding the use of secured corporate bonds issued by corporations with relatively higher credit risk is the relationship of these corporate bonds to the order of priority of loan pledges.

(2) Disclosure of information on covenants

What covenants are granted affects the holder of a corporate bond when the corporate bond is in default and the holder tries to recover the debt. Therefore, it is important for the holders to check the covenants granted on other corporate bonds and loans. They cannot be confident in making an investment in a corporate bond without proper disclosure of covenants granted on other debts.

In Japan, covenants granted on a corporate bond are disclosed in a prospectus as a disclosure item at the time of issuance. In the standard form, covenants of debts including loans are to be disclosed in the annual securities report. But it may be difficult to say that is a commonly used standard practice in Japan.

As of the end of fiscal year ended March 2009, 219 companies disclosed the covenants of loans and other debts in their annual securities reports. Many covenants relate to financial indicators such as the maintenance of net assets
and the maintenance of profits. There were a few companies that disclosed covenants relating to default such as cross acceleration.

✔ In the United States, covenant information on corporate bonds and loans is disclosed as follows:
  a. The annual report Form 10-K discloses basic information such as the type of covenants, whether or not the covenants are granted, and the compliance status (JSDA don’t know the details, as no indication is made as to which covenants are granted on which debts).
  b. If the corporate bond or the loan is subject to important events that require submission of the current report Form 8-K, the detailed information is disclosed on that form.

✔ For the purpose of developing an environment where investors can be confident in making an investment in corporate bonds, JSDA and the market participants need to discuss the following issues based on the disclosure system in the United States, and take measures to properly disclose the necessary information on covenants from an investor protection viewpoint.
  a. Disclosure in an annual securities report (promotion of disclosure of covenants about default);
  b. Statutory disclosure equivalent to the current report Form 8-K in the U.S.;
  c. Timely disclosure required by securities exchanges.
Commissioned company for bondholders

(1) Credit risk of corporation and commissioned company for bondholders

✓ A commissioned company for bondholders is in principle appointed at the time of issuance of the corporate bonds under the Companies Act and acts as a statutory agent of corporate bond holders to monitor the financial condition of the issuer and preserve/recover the debts at the time of default.

✓ Currently, while the commissioned company for bondholders is appointed for corporate bonds targeting individual investors, most corporate bonds targeting institutional investors do not appoint a commissioned company for bondholders.

✓ It is necessary to maintain the current system that enables a corporation with relatively lower credit risk and having a high profile in the corporate bond market to issue corporate bonds flexibly at lower cost. On the other hand, for the purpose of promoting issuance of and investment in corporate bonds of a corporation with relatively higher credit risk, it must be possible to grant various covenants as mentioned above on such corporate bonds. Market participants also need to develop an environment where the commissioned company for bondholders can sufficiently fulfill the role of monitoring financial condition and preserving/recovering debts and where such covenants can be properly reflected in the issuance conditions.

✓ The market participants also need to prepare a system whereby the absence of a commissioned company for bondholders would not damage the credibility of the corporate bonds issued by such companies and the corporate bond market as a whole if the credit risk increases due to deterioration in the business conditions of the issuer.

✓ The market participants can choose two approaches regarding the appointment of commissioned company for bondholders: (a) appoint a commissioned company for bondholders for all corporate bonds; or (b) appoint a commissioned company for bondholders for corporate bonds issued by a corporation with relatively higher credit risk. For the time being, while discussing the tasks taken by the commissioned company for bondholders, the market participants will believe it is useful to establish Approach (b) as a market practice.

✓ In the case of corporate bonds issued by a corporation with relatively higher credit risk, the market participants will need to prepare and illustrate by example a standard model of appointing a commissioned company for bondholders that can be used as a reference for issuers, investors, and securities
companies, and establish the appointment of a commissioned company for bondholders as a market practice.

✓ Currently, many main banks play the role of commissioned company for bondholders. Some market participants are concerned that a conflict of interest could occur before or after a corporate bond default if, in future, corporate bond issuers become more diversified and more corporations with relatively higher credit risk issue corporate bonds. Therefore, the market participants will need to take measures to increase the credibility and transparency of tasks assumed by commissioned company for bondholders as well as discuss what tasks are to be assumed by them.

(2) Commissioned company for bondholders in the future

✓ One of the reasons why many issuers do not appoint a commissioned company for bondholders is that issuers are doubtful about whether the tasks assumed by the commissioned company for bondholders justify the cost incurred by the issuer. On the other hand, commissioned companies for bondholders point out that their responsibilities as commissioned company for bondholders are substantial under the Companies Act.

✓ The relationship between the responsibilities and costs of the commissioned company for bondholders should be considered carefully based on the fact that the credit risk of the issuer closely relates to the responsibilities of the commissioned company for bondholders. The market participants will need to define the tasks assumed by a commissioned company for bondholders and also establish a system whereby these various factors can be properly reflected in the costs through a market mechanism.

✓ Tasks assumed by a commissioned company for bondholders in the United States (i.e., Trustees”) are significantly different before and after a corporate bond default. Particularly, the tasks before default include only administrative processes, such as receiving a disclosure document including the annual report on a regular basis, and do not include the tasks of requesting financial information, monitoring, and review.

✓ Based on the tasks of a trustee in the United States, we need to consider that, for example, the tasks of a commissioned company for bondholders would be limited to the preservation and recovery of debts after the default of corporate bond, or that we would set different requirements for appointing a commissioned
company for bondholders and for its tasks depending on the credit risk of the issuer or the type of investors.

✓ It is possible that the position and the rights of corporate bond holders would be affected by an event concerning the corporate bond issuer besides default, such as mergers and acquisitions (M&A). Therefore, the market participants will need to discuss how to handle event risk as one of the issues relating to the tasks assumed by a commissioned company for bondholders.
§4.07 Improvement of the Transparency of Bond Price Information

(1) As mentioned in §3.04, JSDA manages the system of Reference Statistical Prices [Yields] for OTC Bond Transactions as an infrastructure of corporate bond price information. These Reference prices are widely used by investors and market participants, and are indispensable infrastructure in the financial and securities markets.

(2) However, as the Reference price sometimes diverges from the actual price (such as the execution price and the bid offer) and has a time lag, it is pointed out that we need to review and improve the system.

(3) We need to consider to improve the transparency of corporate bond price information and build credibility for the information:

(See §3.04)
§4.08  Enhancement of Repo market and Settlement systems

To vitalize the corporate bond secondary market, it is necessary to develop and enhance infrastructure such as a corporate bond repo market and a settlement/clearance system. We believe that such efforts would also contribute to expansion of the primary market.

(1) Development of corporate bond repo market

- Although the corporate bond repo market is expected to work as a financing and fund management tool for market participants and as means of avoiding fails, the need for repo transactions is not so large given the current corporate bond issuance size.
- JSDA and the market participants need to hold necessary discussions about how to enhance the securities settlement service functions in advance based on the corporate bond repo market and the lending functions in the United States and Europe in order to cope with the growth in issuance size and the expanding needs of corporate bond repo transactions in the future.

(2) Enhancement of functions of settlement and clearing systems

- A clearing house is indispensable to mitigate settlement risk, to improve the usability of investors and market participants, and to ensure liquidity. However, at the moment, as the issuance size and the transaction of corporate bonds are limited and thus, the netting effect of corporate bonds is not very large, JSDA and the market participants have not established a settlement agency like the one for government bonds.
- JSDA and the market participants need to hold discussions about the establishment of a clearing house for corporate bonds and other functional enhancements of a settlement and clearing system for corporate bonds in order to meet the growth of issuance size and the growing need for a clearing house.
§4.09 Taxation (Withholding Tax on Interest Income, etc.)

(1) Efforts to ensure wide use of the tax-exemption system for interest on corporate bonds held by non-residents

In June 2010, the “Tax-exemption system for interest on corporate bonds held by non-residents (a 3-year temporary measure)” was enacted. This measure intends to promote the investment in and the holding of corporate bonds by foreign investors. JSDA and the market participants need to disseminate this system and properly apply it on a practical basis to ensure its wide use, as well as cooperate with the relevant organizations and agencies to establish this system as a permanent one.

(2) Handling of interest on corporate bonds under unified taxation treatment for financial income

To increase individual investors’ investment in and holding of corporate bonds and public bond investment trusts, we need to create an environment where individual investors will be able to easily accept the investment risks. On the taxation side, it will be very useful to promote the unification of the financial income taxation system and allow individual investors to include their capital loss and default loss on corporate bonds and public bond investment trusts to the aggregation of their financial income for the purpose of taxation. In this case, it is necessary to discuss and solve the so-called “Problem of taxable and non-taxable treatment.” JSDA and the market participants need to continue promoting the unification of tax treatment of financial income in cooperation with the relevant organizations and agencies.
§4.10  Bond Investment Education and Bond IR

(1) It has been pointed out that there are few opportunities to educate individual investors about corporate bonds and that no sufficient basic data are provided for the investment in and the analysis of corporate bonds, such as which corporate bonds are issued and traded, interest rates, and prices.

(2) Some institutional investors have not established an adequate research system and fostered enough analysts to conduct a credit analysis of individual issues, which has become a mid- to long-term issue in the market. Moreover, when investing in a corporate bond, investors in some cases significantly rely on external rating agencies, and tend to adopt a similar investment strategy to those adopted by other institutional investors.

(3) IR for corporate bonds is important as an interactive communication tool between the issuer and investors, and therefore, some people insist that the issuer should carry out IR activities proactively and continuously.

(4) In addition to enhancing and organizing corporate bond investment education programs and the basic data on the corporate bond market, it is necessary to exchange opinions with institutional investors, and actively encourage corporate bond IR activities by issuers for the purpose of promoting further understanding of corporate bond investment.
§4.11 Internationalization of Bond Market and Collaboration with Asia

(1) To implement the concrete measures mentioned above, we need to establish a market that can serve as a good example for the development of corporate bond markets in emerging countries from an international viewpoint. Additionally, we need to fully open the Japanese corporate bond market to the global participants and make it easy to use not only for domestic but also overseas issuers and investors.

(2) The Asian Bond Markets Initiative (ABMI) - an initiative agreed upon at the meeting of financial ministers in ASEAN + three countries (Japan, China, and Korea) - is a scheme to comprehensively consider and take measures to foster the bond market in Asia, promote the issuance of local currency-denominated bonds, expand demand, and improve the regulatory framework and relevant infrastructure.

(3) JSDA and the market participants will continue their cooperation with and support for the ABMI. They also need to take measures that can promote globalization of the Japanese corporate bond market by actively conducting promotional activities and exchanging opinions with foreign market participants to make the Japanese corporate bond market easy to use by foreign issuers and investors, including those in Asia.
§4.12 Foreign Bonds, Forex Control & Liberalization of the Yen

While the currency of denomination for bonds is the currency of a sovereign state, bonds are used not as a means of payment but as a means of high-risk, high-return savings.

Bonds require disclosure of information on the creditworthiness of issuers. Unlike currencies, however, for bonds there is no institution to control supply, such as a central bank in the case of currencies.

However, the markets control the supply of bonds through interest rates. Money laundering regulations and the Patriot Act are not applicable to bonds.

Bonds are created under contracts and, as such, terms and governing laws can be varied for bonds under the principle of freedom of contract.

Unlike currencies, which only sovereign states have the right to issue; bonds represent credit that can be created by the private sector.

However, because the value of bonds is expressed by denomination in existing currencies and because they are paid for in existing currencies (aside from the ECU basket account, which was transformed into the euro, but even in this case the currency basket backs up the currency account), issuance of bonds is fundamentally affected by policies that restrict foreign exchange transactions in the countries of the currencies concerned and policies for the liberalization of those currencies (for example, the Chinese Yuan cannot be taken out of the country at present).

For Asian countries, the liberalization of its currency is an important issue. Japanese experience may be of some use.

The history of Japan’s foreign exchange policy change and yen liberalization related issues as follows:
The history of the relationships in the above may be explained as follows:

1972: GTE stock public offering in Japan (first foreign stock).
1974: 1st German mark public offering of a corporate bond (Mitsubishi Heavy Industries).
1975: 1st Swiss franc public offering of a corporate bond (Mitsubishi Chemical).
1977: ①Expansion of foreign exchange reserves, yen interest rates drop due to a decline in private-sector fund demand: a record issuance of samurai bonds.
   ②Lifting of the ban on the issue of Euroyen bonds by nonresidents: 1st issue by the European Investment Bank (EIB).
1984: Japan-U.S. Yen-Dollar Committee (Japan-U.S. financial market frictions prompting further internationalization of the yen).
   ①Substantial easing of issuer qualifications for nonresident Euroyen bonds.
   ②Lifting of the ban on the issue of Euroyen bonds by residents: Euroyen bonds, 1st issue = Mitsubishi Heavy Industries’ Euroyen CB worth ¥30 billion (180-day restriction on the recycling of Euroyen bonds to Japan = ban on bringing them in).
1985: Plaza Agreement (major industrialized nations’ coordinated response to dollar interest rate rises due to the U.S. trade and fiscal deficits): the managed floating exchange rate system.
1990: Weakening of the yen following the collapse of the bubble economy in Japan.
1993: Abolishment of regulations on corporate bond issuance limits and revision of the trustee company system.
1994: Abolition of recycling restrictions on sovereign Euroyen bonds = 1st Alpine bond issued.
1996: Foreign exchange control abolished under the Tokyo Big Bang by the Hashimoto Cabinet - Abolition of recycling restrictions on Euroyen bonds issued by residents.
1997: The Asian currency crisis, and failures of Sanyo Securities, Hokkaido Shokutaku
Bank, Yamaichi Securities.
1999 : Appreciation of the yen in the wake of the bursting of the U.S. IT bubble.
2006 : Electronic registration of corporate bond certificates started.
2010 : Announcement of the commencement of the TOKYO PRO-BOND Market.
Questionnaire 5: High level description of the securities settlement system

(The following items are just for the reference)

- **Legal definition of debt instruments**
  - Existence of uniform legal framework for (all / certain) types of securities
  - Dematerialization / Immobilization vs. Physical securities
  - Legal ownership structure of dematerialized / immobilized securities
  - Legal ownership transfer mechanism

- **Securities settlement infrastructure**
  - Existence of CSD and Book entry system for debt instruments
  - Existence of DVP and RTGS mechanism
  - Existence of post-trade matching mechanism
  - Existence of execution matching mechanism
  - Settlement scheme (Gross-Gross, Gross-Net, Net-Net) for Corporate Bond, Government Bond and other debt securities
  - Settlement cycle for Corporate Bond, Government Bond and other debt securities

- **Challenges / Expected changes**
  - Issues on current settlement infrastructures
  - Expected changes on settlement infrastructures
Answer 5

§5.01 Securities settlement infrastructure
   (This part has not yet finalized)

[1] Legal definition of debt instruments

(1) Existence of uniform legal framework for all types of securities
   • See Answer §5.02 [1] “Book-Entry Bond Transfer System”
   • “Law Concerning Book-Entry Transfer of Corporate Bonds, Stocks, and Other Securities” provides the legal basis for the Book-entry transfer system and dematerialization of all securities.
   • JSDEC provides the role of the CSD (Central Securities Depository) in book-entry transfer system in the securities other than government bonds. In this law, the term CSD means "Designated Depository Institution." The book-entry bond transfer system participants must observe the rules established by the Depository Institution.

(2) Dematerialization / Immobilization vs. Physical securities
   • As described above, according to this law and the above system for securities to be distributed, it has realized the complete dematerialization.
   • The Companies Act allows that the form of physical bond certificates to be issued regardless of the book-entry transfer method. However, in this case distribution in the market cannot be expected, also not allowed to be owned in tax exempt status under the Japanese taxation system.

(3) Legal ownership structure of dematerialized / immobilized securities
   • In the Book-Entry Transfer institutions, the securities companies and financial institutions, as "Account Management Institution" to open an account for securities transfer.
   • In the transfer account, the balance of the own account and the overall customer account are recorded respectively.
   • Bondholders open the transfer account in the Depository Institution or account management institution. By performing an electronic transfer to an account transfer record, the securities are entitled to be owned by the bondholder.
   • In other words, the presence of the recording consists of a proof of a "Perfection third party to the issuers."
   • Should if there is an insufficient transfer account book records in the customer's
account due to the over-recording, the "duty of retirement of over-recording" is generated by management institutions.

[2] Securities settlement infrastructure

(1) Existence of CSD and Book entry system for debt instruments
- JASDEC (Japan Securities Depository Center, Inc.) act as CSD, provide Book-Entry Transfer System for Corporate Bonds, etc.
- BOJ (Bank of Japan) act as CSD, and provide Book-Entry Transfer System for JGB.
Table §5.01-1. JASDEC Book-Entry Transfer System for Corporate Bonds

*Quotation from JASDEC HP.*
Features of Book-Entry Transfer System for Corporate Bonds

(a) Complete Dematerialization
Issuers are able to issue in dematerialized form and investors are not allowed to request issuance of bond certificates. Reduction in issuance cost is expected, because no certificates are needed, including sample bond certificates and spare bond certificates.

(b) Book-Entry Transfer System by balance management
Maintenance of smooth settlement by introduction of Book-Entry Transfer System, which enables right transfers by electronically recording of the increase and the decrease of the balance in the Transfer Account Book.

(c) Multi-layer Holding Structure
Multi-layer holding structure shall be composed of Book-Entry Transfer Institution, Account Management Institutions (=AMIs) and investors. AMIs can be positioned in a multi-layer holding structure in order to enable flexibility of business development for AMIs and affiliation among international institutions.

(d) DVP (Delivery Versus Payment)
Reduction of settlement risks has been improved due to DVP settlement, from issuance to redemption, including transfers.

(e) STP (Straight-through Processing)
Business operation efficiency has been improved by linking with the pre-settlement matching system (PSMS), which realizes the straight-through processing from trade matching to settlement.

Eligible Securities of Book-Entry Transfer System for Corporate Bonds
- Corporate bonds
- Municipal bonds
- Investment company bonds
- Corporate bonds issued by mutual companies prescribed in the Insurance Business Act
- Specified corporate bonds prescribed in the “Law Concerning Liquidation of Assets”
- Rights that should be represented by bond certificates issued by companies under special law
- Rights that should be represented by bond certificates issued by any government or by companies in foreign countries, such as Samurai Bonds.
(2) Existence of DVP and RTGS mechanism

- JASDEC provide securities transfer system, and BOJ provide fund transfer system. DVP mechanism consists of Both System which is related mutually.

Table §5.01-2. Securities Market Infrastructure in Japan
DVP mechanism

(a) JASDEC records the increase/decrease in the balance of beneficial rights in the transfer account book after PSMS confirmation.

(b) JASDEC’s system is linked to the Bank of Japan's Financial Network System (BOJ-NET) at the system level, enabling the use of Delivery versus Payment (DVP) settlement, which involves executing the settlement of funds and recording the increase/decrease in the balance of beneficial rights in the transfer account book at the same time.

Table §5.01-3. DVP mechanism

*Quotation from JASDEC HP.

(3) Existence of post-trade matching mechanism

- JASDEC provide PSMS (Pre-Settlement Matching System) for Book-Entry Transfer System for Corporate Bonds (See Number 2 and 3 in above Fig.)
(4) Existence of execution matching mechanism
   JASDEC provide PSMS and Securities Transfer System as a set. Settlement Party use PSMS to instruct about securities transfer of Corporate Bonds.

(5) Settlement scheme (Gross-Gross, Gross-Net, Net-Net) for CP, Corporate Bond, Government Bond and other debt securities
   Settlement scheme of JASDEC for Corporate Bond and CP is Gross-Gross.

(6) Settlement cycle for CP, Corporate Bond, Government Bond and other debt securities
   Settlement cycle is currently T+3 (Trade Date + 3 days)
   Working Group of JSDA (Japan Securities Dealers Association) is now discussing about shortening of settlement cycle of JGB.

3. Challenges / Expected changes
(1) Issues on current settlement infrastructures
   Lack of Liquidity provision mechanism and Liquidity-Saving mechanism on the current JASDEC’s Book-Entry System for Corporate Bonds.
(2) Expected changes on settlement infrastructures
   CCP (Central Counter Party) is expected Reduction of settlement Risk and providing netting facilities.
   The realization of Liquidity-Saving mechanism with the Next Generation RTGS of the BOJ-NET is expected.
§5.02 Details of the Book-Entry Bond Transfer System

[1] Book-Entry Bond Transfer System

Investors used to hold bonds in various forms – more specifically, in physical certificates that had been issued by the issuer; in registered form, where bondholders were registered on the registry at the registrar designated for the issue; and as book-entry JGBs, where physical certificates were deposited with the BOJ so that trades could be settled by book-entry transfers (within a system established in 1980) among the accounts of brokers and other system participants.

In recent years, however, with the increasing bond trading volume and a growing call for a flexible framework and an expedited process for the settlement of transactions, certificates, which needed to be physically delivered, or registered bonds, whose transfer required amendment in records of bond-specific registries, hardly stood the test of practical use, while the book-entry transfer system for JGBs had several shortcomings.

This situation first led to the argument for the review of the settlement procedures for bonds at that time and, later, for the complete overhaul of the securities settlement system in Japan.

There had been a growing perception that Japan urgently needed to renovate the existing system to create a safer and more efficient infrastructure that would make the country’s securities markets globally competitive.

Against this background, the securities settlement system reform law was enacted in June 2002, and, pursuant to its provisions, the existing legislation for book-entry transfer was later amended and renamed the “Law Concerning the Book-Entry Transfer of Corporate Bonds and Other Securities” with objectives including the complete dematerialization of securities, the shortening of settlement cycles, and the reduction in settlement risk.

The amended law provided for the legal framework of new book-entry transfer systems for corporate and government securities.

(This law was revised to the “Law Concerning Book-Entry Transfer of Corporate Bonds, Stocks, and Other Securities.”)

On the basis of that framework, the BOJ renovated the existing JGB book-entry system in January 2003, and the Japan Securities Depository Center (JASDEC) started
operating a new central custody and book-entry transfer system for securities, including nongovernment bonds in January 2006.

These book-entry transfer systems have a multitier, tree-like structure, with a central custody and transfer agent – the BOJ in the case of JGBs, TBs, and FBs and JASDEC, in the case of the other eligible securities – on the top tier, from which account management institutions, securities companies, and other institutions with respective master accounts in the system and system participants, other securities companies, and investors that have an account at one of the account management institutions cascade down as subsequent tiers or branches.

Bond holdings of system participants are registered or recorded in the transfer account book kept by the account management institution at which they have an account.

In principle, all bonds are deposited with the central custody agency at the time of issuance, and the entire issue is dematerialized.

None of those book-entry bonds may be withdrawn over their life in the form of either physical certificates or registered bonds.

The previously mentioned Securities Settlement System Reform Law also provided measures to affect the abolition of the Corporate Bond Registration Law following the set up of the book-entry transfer systems.

[2] Development of a Securities Settlement System in Japan by the Japan Securities Depository Center (JASDEC)

What is the Japan Securities Depository Center (JASDEC)?

The Japan Securities Depository Center (“JASDEC” below; this term will also be used for the current Japan Securities Depository Center, Inc.) was established as a non-profit foundation on December 6, 1984 with the objective of streamlining the delivery of stock certificates.

On 27th of May, 1985, JASDEC was designated as a depository under the Central Securities Depository Law (1984 Law, No.30, and “CSDL” below) by the Minister of Justice and the Minister of Finance and commenced depository services on October 9,
In the process of reforming the securities settlement system, there was growing debate on the corporatization of JASDEC.

Given the pressing need for the reform of the securities settlement system in Japan, it became essential to build a securities settlement system which is globally competitive and convenient for market users.

Thus it became necessary to develop as soon as possible a securities clearing organization to implement the securities settlement system, equipped with globally competitive capability.

There were also discussions along these lines at the Financial System Council of the then Ministry of Finance. In its report submitted in June 2000 entitled “The New Financial Framework for the 21st Century”, the Council indicated that “It is preferable that a securities settlement organization which handles various types of securities should emerge”.

In addition, the Council proposed in the same report that it would be essential to establish a securities clearing organization structured to “be constantly self-motivated to improve its own services in order to respond positively and flexibly to environmental changes”, and “for this to be realized, it would be critical to improve governance to appropriately reflect user opinions and to ensure contestability.”

The Financial System Council also proposed that “the way JASDEC is managed should be reviewed from a broad perspective, including governance functions and organizational structure.”

In accordance with this proposal, the Committee for Reform of the Securities Clearing and Settlement System within the Japan Securities Dealers Association (JSDA) established a working group “to review the structure and management of JASDEC”, which discussed JASDEC’s governance and other operational functions, and the pros and cons of its corporatization (reorganization to Joint Stock Company or demutualization).

As a result of these discussions, a report was submitted in September 2000, which recognized the need for JASDEC’s corporatization from the viewpoint of expandability and increased operational efficiency.

Upon its corporatization, it was decided that JASDEC should be structured in a manner that ensures that its governance function reflects user opinions.

In the process of corporatizing JASDEC, the aforementioned Advisory Board on Securities Delivery and Clearing Reform formed a special committee to review specific matters such as basic corporate philosophy and the amount of capital, and in November
2001, the committee submitted a report entitled “Specific Framework for Corporatization of JASDEC.”

Corporatizing JASDEC was judged to be a preferable approach to realizing the required to change the CSD (Central Securities Depository) to enable JASDEC’s corporatization. The changes to the CSD were instituted in April 2002, officially making JASDEC a company with shares.

The process of corporatizing JASDEC was not the same as that used in the case of the Tokyo Stock Exchange, the legal person (corporate) status of which remained the same when the legal entity as a legal person with members was restructured as a company with shares.

This is because the Japanese judicial system governing the legally incorporated foundations like JASDEC, which were public-interest corporations, differs significantly from the legal system governing business corporations, i.e., profit-making corporations.

And there is no system under existing legislation that allows public-interest corporations to restructure themselves to become another kind of legal entity such as profit-making corporations, while maintaining their legal person (corporate) status.

Thus, as a means of converting a public-interest corporation to a business corporation, the authorities adopted the method of transferring the operation of the incorporated foundation to the business corporation after its dissolution, in order to enable the practical corporatization of the public corporation.

In terms of specific procedures, a new company to which depository services were transferred was established in January 2002, and through subsequent capital injection, the framework of the business corporation was laid out.

In June 2002, JASDEC became a business corporation after the authorities concerned approved the transfer of business.

In addition, the Law Concerning the Transfer of Short-term Bonds (CP: Commercial Papers) was put into force, which governs the issuance of electronic commercial papers.

Because the depository organization is required by law to be a business corporation, JASDEC had to become a business corporation in order to process electronic CPs.

On January 10, 2003, JASDEC was designated under the Law Concerning Book-Entry Transfer of Corporate Bonds, etc. (2001, No.75, termed Law on Bond Book-Entry Transfer below) as a depository agency, to handle various kinds of securities, and began to play a crucial role in the paperless issuance of bonds under the law.

The corporate policies of JASDEC, as a business corporation, are (1) to focus on users and pursue highly transparent management, (2) to provide functions equivalent to those of an overseas CSD, and (3) to provide extremely safe and less expensive services.
Given its public nature as a social infrastructure, many of JASDEC's directors are representatives of participating securities firms and banks, in order to ensure governance by participants.

An Operations Committee was formed to take opinions from business experts and make changes on their basis. Subcommittees were also formed for different projects, the proceedings of which are published on the JASDEC website.

[3] JASDEC and the promotion of reform of the securities settlement system

In recent years, many countries have vigorously proceeded with reform of their securities settlement systems in order to enhance their competitiveness in capital markets.

Japan is also engaged actively in the reform process, employing IT technologies and launching the DVP (Delivery Versus Payment = a settlement system to avoid outstanding balances) and STP (Straight Through Processing = electronic processing of trading through settlement).

(1) Establishment of short-term corporate bond (electronic CP) depository and book-entry transfer system

On the 10th of January, 2003, JASDEC was designated a depository institution under the “Law Concerning Book-Entry Transfer of Corporate Bonds, etc.” and commenced operation on the 31st of March.

Traditionally, commercial papers were in the form of paper notes and had to be delivered to the assignee for settlement in Japan since 1987.

Under the new JASDEC system, CP processing became paperless, completing the process of CP issuance, redemption, and transfer through the electronic paper book-entry system. Through this system, the settlement cycles can be shortened, potential risks pertaining to the delivery of printed securities are eliminated, and custodial costs are also abolished.

JASDEC’s short-term corporate bond depository and book-entry transfer system adopts the DVP settlement system, which handles individual securities and related capital in a set (also called gross=gross type, BIS 1 model).

The DVP settlement system, which settles individual accounts on a real time basis, ensures the security of transactions and materializes the settlement of accounts, which satisfies issuer’s need for quick financing.

The limited type of the face value of CP notes was also harming distribution.
As stamp duty is imposed by individual paper note, the issuers tried to reduce the printing cost by issuing CP in a larger face value.

Electronic commercial papers avoid such constraints, enabling the issuance and transfer of CP in smaller values. And as a result electronic commercial papers create flexibility in capital management and financing.

(2) Implementation of the general DVP settlement system

The DVP settlement system is essential to avoiding the principal risk (due to non-payment of price or non-receipt of securities notes).

In addition, coordinated operation between the DVP settlement system and the STP system is required for efficient DVP settlement.

In particular, there was a significant need for such settlement with institutional accounts.

The general DVP settlement system for stocks, etc. was commenced in May 2004 to launch the DVP settlement scheme for the settlement of shares for securities firms, trust banks targeted at institutional investors, and standing proxy (custodian) banks.

The securities gross type (=capital net type) DVP settlement system was introduced to this settlement system, linking the settlement order information for the settlement of securities such as stocks, via the pre-settlement matching system (PSMS), which enabled efficient DVP settlement.

This DVP settlement system settles securities transactions by each settlement order, i.e., by the gross of individual transactions.

The JASDEC DVP Clearing Corporation (JDCC), a wholly owned subsidiary of JASDEC, undertakes clearing services as CCP (Central Counter-Party=clearing organization to accept debts and credits for those concerned and settle the account) by taking collaterals from the DVP clearing parties and managing risks.

While the capital is settled in a net amount at the end of the day, as the DVP Clearing Corporation (JDCC) manages risk, DVP settlement with no principal risk is realized. DVP settlement parties are required to pledge a membership fund (cash) to DVP settlement.

In terms of settlement of stocks, the Stock Exchange DVP Settlement System has been operating for Exchange Trading (stock exchange trading/DVP settlement was launched in the Tokyo Stock Exchange and the Osaka Securities Exchange in May 2001. The Japan Securities Clearing Corporation has also implemented DVP as CCP since January 2003.
[4] Expansion of Pre-Settlement Matching System (PSMS)

The Pre-Settlement Matching System (PSMS) enables institutional investors, securities firms and trust banks to handle post transaction checking via electronic processing (eliminating the person-hours required to send Faxes or make calls).

JASDEC implemented the Pre-Settlement Matching System (PSMS) for domestic trades by domestic institutional investors in September 2001.

In February 2002, PSMS was expanded to cover trades by non-resident investors, public offering, placement, and trading of corporate bonds with share warrants (convertible bonds and corporate bonds with share warrants before the revision of the Trade Act on the 1st of April, 2002).

In addition, in May 2003, PSMS was expanded to cover Japanese Government Bonds (JGB), futures/options and transmission of information on net asset value per share and information on price setting/termination from securities investment trust management companies to trust banks.

When the general DVP clearing system was launched in May 2004, the operational linkage with PSMS was materialized.

To further improve the level of services, PSMS commenced operation to handle JGB repo trading and commenced providing pre-settlement matching services for the newly established Japan Government Bond Clearing Corporation (JGBCC).

Since January 2006, PSMS has been connected to the depository and settlement system for short-term corporate bonds (CP) as well as for general bonds.

[5] Implementation of depository and clearing system for general bonds (corporate bonds, investment-and-loan bonds, and local bonds)

Historically, in Japan the settlement of corporate bonds, investment-and-loan bonds, and local bonds was processed through the renewal of registration at about 160 registration agencies throughout the country.

While the “Japan Bond Settlement Network”, commonly called JB-Net, functioned to connect the registration agencies and market players, and the system to electronically process DVP settlements existed via a linkage with BOJ Net, there were still many physical invoice transactions issued in writing.

Thus the overall depository and settlement system for general bonds was still inefficient and it remained difficult to increase its quality.

It was considered that a hierarchically structured depository and settlement system
was required to enable efficient settlement. Efforts have therefore been made to enact related laws to enable reform of the securities settlement system in Japan.

In January 2003, the “Law Concerning Book-Entry Transfer of Corporate Bonds, etc.” went into effect to allow paperless settlement of general bonds.

In January 2006, JASDEC inaugurated its book-entry transfer system for Corporate Bonds, becoming the only settlement agency which processes book-entry transfers in Japan.

As this system presupposes the application of STP in the DVP settlement, it led to a significant advance in the application of STP/DVP in securities settlement in Japan.

The transition period for existing bonds issued as cash bonds and registered bonds ends in January 2008.

The efficiency of corporate bond settlement should significantly improve when the transition is completed, and the liquidity of the Japanese corporate bond market is also expected to increase significantly.

[6] Paperless processing of stock certificates (computerized processing of stock certificates)

Paperless processing of stock certificates is the final goal of computerizing processing of securities instruments. The computerized processing of stock certificates was the last procedure to be initiated in the gradual transition to computerization because intensive study of its effects was required.

This is because stock trading emphasizes investor rights (right to self-interest and right to common interest) such as dividends and voting rights, and these rights of stock owners are registered on a stockholder list. In addition, there are many stockholders, the majority of whom are keeping their stock certificates on hand.

JASDEC has been providing depository services as a depository center for stock certificates since 1991. At present, about 75% of issued shares of listed companies are deposited with JASDEC.

In terms of the settlement of the shares listed at stock exchanges between securities firms, JASDEC facilitates deposit of securities without any physical delivery of securities.

In a similar manner, transactions by institutional investors and non-residents are processed by securities firms (brokers and dealers) and custodian banks in most cases through JASDEC’s depository and clearing system without any physical delivery of securities.
In this sense, while computerization of securities trading had in fact been broadly implemented, there was a limit to the extent that administrative costs required for depositing and transferring share certificates or the cost on issuers was reduced, since there were a relatively large number of actual stock certificates.

The Legislative Council of the Ministry of Justice proposed in 2003 to introduce a system which promoted computerization, and in the following year the Financial Services Agency and the Ministry of Justice submitted a proposal for the revision of the Law Concerning Book-Entry, Transfer of Corporate Bonds, etc. and the Commercial Law to the Diet, which passed the revisions.

Before the listed companies and market players actually adopt this system, administrative procedures, market practices, and computer system design need to be considered.

Furthermore, it is essential to familiarize investors (stock holders) with the new paper-less system and raise the ratio of the pre-depository of the paper based stock certificates with JASDEC in order to ensure a smooth transition.

The computerization of stock certificate processing is scheduled to be realized in 2009.

[8] Conclusion

The reform of the securities clearing and settlement system in Japan has made significant progress through the establishment of settlement agencies and the realization of cross-sectoral computerization of securities processing, which have advanced institutional reforms. As a result of efforts made by the business sector, including JASDEC, the implementation phase may be in the final stage.

While at present there is some cost in terms of system investment in developing the securities settlement system, it is desirable that not only market players but also investors and issuers enjoy the benefits of computerization through the improvement of user convenience and cost reductions via the realization of STP, DVP, and paperless processing.

In order to achieve this goal, both JASDEC and market players should set up a specific goal to improve the efficiency of the securities settlement system and to raise Japan’s global competitiveness.

JASDEC’s basic corporate philosophy (established in June 2006) is that it “recognizes its public role as the only securities depository center in Japan, and the continuous changes in both the domestic and the international environment and investment
structures surrounding the capital market, while, from the viewpoint of both investors and users, JASDEC contributes to the development of society and the functions of the securities market, as a leader of the reform in the securities clearing and settlement system aimed at building highly credible, convenient and efficient securities clearing infrastructure."

It is essential for market players (=JASDEC sponsors) to share this concept and cooperate with each other to improve the level of capital market infrastructures in Japan as well as in the Asian region, under a national strategy.
Questionnaire 6: Costs and charging methods

(The following items are just for the reference)

(The following items are just for the reference)

- **Average issuing costs for Corporate Bonds and CPs**
  - Registration fee at CSD
  - Transfer fee (CSD, Bank)
  - Underwriting fee
  - Fiscal Agent fee
  - Other fees

- **Average on-going costs for Corporate Bonds and CPs**
  - Maintenance fee at CSD
  - Interest payment / redemption fee at CSD
  - Interest payment / redemption fee at Paying Agent
  - Brokers commission (if applicable)
  - Other fees
Answer 6

§6.01 Initial Fees

(This part not yet finalized)
§6.02 Maintenance (on-going) Costs

(This part not yet finalized)

1. Coupon Payment

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2. Redemption

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*CPの場合、IPAとしての発行時及び償還時手数料は数千円／1件が一般的と思われます

3. Agent

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<tr>
<td>A</td>
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<tr>
<td>BBB</td>
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</tr>
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</table>

Credit rating fee will vary greatly depending on the target, content and the size.
Questionnaire 7: Market size / statistics

(The following items are just for the reference)

- **Market size from the following point of view (by Local Currency)**
  (Outstanding amount end of the year and yearly issuing amount)
  - Capital market (Direct financing) vs. Bank loans (In-direct financing)
  - Capital Market instruments and their outstanding amount
  - Domestic financing vs. International financing
  - Public placement vs. Private placement
  - Primary market vs. Secondary market (with roll-over volume)

- **Main players in the market**
  - Type of issuers (domestic vs. international, financial vs. non-financial)
  - Type of investors (banks, institutional investors, etc.)
  - Underwriters (banks, investment bankers, etc.)
  - Fiscal Agents (banks, custodians, etc.)
  - Other participants

- **History of Debt Market development**
  - Historical growth by instrument type
  - Major events which trigger the market growth
Answer 7

§7.01 Present State of the Bond Issuing Market

The total value of public and corporate bonds issued in fiscal 2008 (ended March 31, 2009) contracted 9.3% from the previous year to ¥156.9 trillion ($1.74 trillion at the rate of ¥90 to the dollar; please refer to the notes of the table on the following page).

Of this amount, ¥123.9 trillion, or 79% of the total value, was accounted for by government bonds, underscoring their dominant presence in the public and corporate bond market in Japan.

Up until fiscal 2007, JGB issuance had been on the decline along with the upswing in the central government’s financial position, but issuance is forecast to mount again given the deterioration in the government’s finances caused by the slump in the economy following the Lehman Shock in September 2008. JGB issuance can be broken down into super long-term government bonds (¥16.8 trillion, or $186 billion); long-term government bonds, including those sold to individual investors and those whose interest rates are linked to the consumer price index (¥28.2 trillion, or $313 billion); medium-term government notes (¥48.2 trillion, or $535 billion); and Treasury bills (¥21.0 trillion, or $233 billion).

In fiscal 2008, ¥6.3 trillion ($70.0 billion) worth of municipal bonds were publicly offered—6.7 times greater than the volume (¥940 billion) of those issued 18 years ago (fiscal 1990).

The increase is basically due to the deterioration in the fiscal position of local governments, but the introduction of mini-local bonds, which are publicly offered and targeted at local residents, in fiscal 2001, and joint local government bonds, publicly offered baskets of local bonds, in fiscal 2003 also played roles.

Also boosting the combined issue value of public debts were debt securities issued by government agencies — government-guaranteed bonds (¥4.8 trillion) and FILP agency bonds (¥4.2 trillion).

Following the reform of the fiscal investment and loan program, the Government Housing Loan Corporation issued ¥50 billion worth of the first FILP agency bonds in fiscal 2000. Since then, the combined value of FILP agency bonds issued has grown
annually, rising to ¥4.9 trillion in fiscal 2007.

The amount of bank debentures issued in fiscal 2008 stood at ¥5.5 trillion ($61.1 billion), down from ¥43 trillion ($477.7 billion) in fiscal 1995. Looking at issuance by category, discount debentures were (¥1.0 trillion or $11.1 billion) and coupon debentures (¥4.5 trillion, or $50.0 billion).

In particular, the annual value of discount debentures issued has decreased sharply from the ¥30 trillion ($333.3 billion) issued in fiscal 1995. Behind this decline was the Bank of Tokyo-Mitsubishi (now the Bank of Mitsubishi-Tokyo UFJ)'s decision to stop issuing bank debentures in March 2002, followed, in turn, by Mizuho Bank's (including Mizuho Corporate Bank) decision in March 2007 to discontinue issuance except those for workers' asset-building, or zaikei, programs.

These and other market movements suggest Japanese industry's dependency on long-term credit banks as a source of long-term capital is coming to an end.

The total issue value of corporate straight bonds fell to ¥9.6 trillion ($106.6 billion) in fiscal 2008, down from a peak of ¥10.5 trillion ($116.6 billion) in fiscal 1998.

The trend probably can be partly attributed to the fact that investors have grown increasingly wary of credit risks and their preference for JGBs (flight to quality) has strengthened.

Meanwhile, once depressed in the aftermath of default on Argentine government debt in 2002, the issuance of yen-denominated foreign bonds was steadily recovering after the turmoil regarding U.S. issuers' interest taxation by the dematerialization of bonds issued in Japan put a temporary halt to the recovery in 2006.

However, with total issue values of ¥2.6 trillion and ¥2.1 trillion in fiscal 2007 and fiscal 2008, the issuance of yen-denominated foreign bonds is on the rise again.
Table § 7-1-1. The Value of Bonds Issued in Japan

(This part has not yet been finalized)

(This part will be followed later.)

Source: "Compiled on the basis of JSDA and JASDEC publications"
Table §7-1-2. The Outstanding Amount of Bonds Issued in Japan
(This part has not yet been finalized)

Source: "Compiled on the basis of JSDA and JASDEC publications"
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Broader Classification of Concerns to be Solved Behind the Regulations or Practices in Each Bond Market

(Eight Focal Points for Answering the Questionnaires)

Shuji Yanase
Nagashima Ohno & Tsunematsu
TSE’s Legal Counsel for ABMF

Eight Focal Points for Answering the Questionnaires

1. Protection of Investors from Fraud or Misrepresentation
2. Establishment of Legal Rights of Bondholders
3. Secondary Market for Exit of Investment before Maturity of Bonds
4. Protection of Bondholders in Financial Difficulty of the Issuer
5. Costs of Finance by Issue of Bonds
6. Supervision of Financial Institutions
7. Professional Investors or Professional (Wholesale) Market
8. Use of Independent Accountants and Lawyers
(1) Protection of Investors from Fraud or Misrepresentation

In connection with transactions of Bonds, fraud may easily take place or misrepresentation (including omission to state material facts) may occur.

(a) At the time of issue of Bonds
   • Shall the Regulator evaluate the Bonds, or shall the investment decision be made by proposed purchasers?
   • The information concerning the issuer and the terms of Bonds which is given by the issuer at the time of offering of Bonds is correct?
   • Is the credit rating provided by rating agencies reliable?
(b) In sale of outstanding Bonds.
   • The information concerning the issuer and the terms of the Bonds which is made available to the proposed purchaser is correct?
   • Is the transparent price information available to the proposed purchaser?
   • Is the rating provided by rating agencies reliable?
(c) Is the pricing of Bonds made properly?

(2) Establishment of Legal Rights of Bondholders

Terms of Bonds are not determined by negotiations with proposed purchasers of Bonds, but are determined by the issuer and the financial institutions arranging for the issue. Bondholders may not be protected properly by clear legal rights as stipulated in the Bonds, and will also have difficulty in exercising, or enforcement of, their rights against the issuer.

(a) Shall the Regulator intervene the process of determination of the terms of Bonds, or shall the determination of the terms of Bonds be left entirely to the issuer and the financial institutions arranging for the issue?
(b) Shall the financial institutions be under any obligations to ensure fairness of the terms of Bonds?
(c) Shall the financial institutions undertake any obligations to act for the benefit of Bondholders, for the payment of interest or redemption of Bonds?
(d) Are there reliable custodians of Bonds?
(e) How to secure effective transfer of Bonds? Do we need Bond certificates? Is the book transfer reliable?
(3) Secondary Market for Exit of Investment before Maturity of Bonds

Bondholders may wish to sell Bonds before their maturity, but it may not be easy to find their purchasers.

(a) Does the secondary market properly exist to ensure liquidity of Bondholders’ investment? Are there purchasers of outstanding Bonds?
(b) Information regarding the issuer and price information are available in the market?

(4) Protection of Bondholders in Financial Difficulty of the Issuer

In case the issuer of Bonds become bankrupt, it would not be easy for the Bondholders to act effectively, either individually or collectively, to protect the interest of Bondholders.

(a) Are there proper measures available to Bondholders to exercise their rights?
(b) Shall the financial institutions undertake the duty to act in favor of or on behalf of Bondholders to collectively and effectively exercise Bondholders rights?
(5) Costs of Finance by Issue of Bonds

The costs charged to the issuer as well as the costs charged to Bondholders, with respect to the issue, purchase, payment of purchase price, custody, interest payment and redemption should be reasonable and fair.

(a) How would it be possible to minimize such costs to the issuer and at the same time to make the corresponding fees receivable by the financial institutions and other parties reasonable?

(b) Should the fees and charges be regulated, or should they be determined through competition among financial institutions and other parties?

(6) Supervision of Financial Institutions

Bond Market constitutes an important part of infrastructure of the financial system, and accordingly the financial institutions and other parties acting in respect of Bond Market should serve for the public interest.

(a) How should they be regulated?

(b) How would it be possible to secure innovation and quick response to market needs? How much discretion should they have in doing their business?

(c) Are the self-regulations, through for instance codes of conduct adopted by groups of relevant parties, desirable?
(7) Professional Investors or Professional (Wholesale) Market

Professional investors are different from retail investors. Professional investors have knowledge and experiences to protect themselves and are also in a position to collect information regarding the issuer and pricing and are capable of exercising their rights under the terms of Bonds.

(a) Is it desirable to treat professional investors differently from retail investors with respect to disclosure requirement and other measures of protection of investors?
(b) Once Bonds are issued to professional investors, how shall we ensure that (i) they are not sold to retail investors or (ii) retail investors who have purchased them from professional investors are properly protected?
(c) How should we define professional investors for these purposes?

(8) Use of Independent Accountants and Lawyers

Independent accountants and lawyers are capable of providing useful information to investors with respect to issue of Bonds.

(a) To what extent shall we oblige the issuer of Bonds to obtain at its expense opinions of accountants and lawyers for issue of Bonds?
(b) How frequently or on what occasion shall the issuer of Bonds ask accountants and lawyers to issue or update their opinions?
Government Debt Management Policy

Kohei Noda
Deputy Director of Debt Management Policy Division
Financial Bureau, Ministry of Finance, Japan

Agenda

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I. JGB Products / Issuance Plan

Categories of JGB - Based on Purposes

- **New Financial Resource Bonds**
  - Construction Bonds
  - Special Deficit Financial Bonds
  -- To finance annual fiscal needs

- **Refunding Bonds**
  -- To raise funds to redeem matured bonds

- **FILP (Fiscal Investment and Loan Program) Bonds**

The Fiscal Investment and Loan Program (FILP) is an investment and loan activity which provides essential long-term and low-interest funds for policy, which are difficult to be provided through private funding. FILP enables the execution of large-scale and very long-term public projects with the capital procured by issuing FILP bonds or a kind of government bonds. Specifically, it provides long-term, fixed and low-interest capital in the areas pertaining to small and medium-sized enterprises, and also invests in the fields related to exploration or research and development, of natural resources.
FILP Structure

60 Year Redemption Rule

New Issue
(Revenues from New Financial Resource Bonds)

Refunding Bonds
(Finances through Government Debt Consolidation Fund Special Account to appropriate for redeeming)

Issuance and Redemption of General Bonds

Outstanding:

- 600
- 500
- 400
- 300
- 200
- 100
- 0

Redemption:

- After 10 years: 400
- After 20 years: 300
- After 30 years: 200
- After 40 years: 100
- After 50 years: 100
- After 60 years: 0

Issuance of Refunding Bonds:
Categories of JGB
- Based on Terms and Conditions

Average Maturity

【The Average Maturity of JGB Market Issuance “Calendar Base”】
(Note) FY2005-2009: Actual figures, FY2010: Figure based on the initial issuance plan
10-year Inflation-Indexed Bonds (JGBi)

< assumption >
- Face value: 10 billion yen; coupon rate: 3%
- CPI: 2% p.a.

![Diagram showing the calculation of inflation-indexed bonds](image)

(Note1) The above CPI increase ratio and coupon rate are purely hypothetical.
(Note2) CPI is seasonally-unadjusted core CPI which excludes perishables such as fresh foods and fish, but not rice or energy.

15-year Floating-Rate Bonds

- Reference rate used for 15-year floating-rate bonds is linked to the interest on 10-year fixed-rate bonds (interest on 10-year fixed-rate bonds - α).

![Diagram showing yield curve sensitivity](image)

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<td>Interest rate change</td>
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Historical Changes in JGB Issuance Plan

### Historical Changes in JGB Issuance Plan

**(Unit: billion yen)**

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<th>Year</th>
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<th>Construction Bonds</th>
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<td>24,000</td>
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**Note:** Figures may not sum up to total because of rounding.

### JGB Issuance Plan for FY2010

**<Obligations by Final Funds>**

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<tr>
<th>实际行动</th>
<th>新财源资金债券</th>
<th>基建债券</th>
<th>特种财政融资债券</th>
<th>再融资债券</th>
<th>FILP债券</th>
<th>总计</th>
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<tbody>
<tr>
<td>百亿元</td>
<td>22,294.0</td>
<td>53,450.0</td>
<td>10,000</td>
<td>44,000</td>
<td>10,000</td>
<td>114,000</td>
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<tr>
<td>FY2009 (初值)</td>
<td>22,294.0</td>
<td>53,450.0</td>
<td>10,000</td>
<td>44,000</td>
<td>10,000</td>
<td>114,000</td>
</tr>
<tr>
<td>FY2009 (2次追加予算)</td>
<td>22,294.0</td>
<td>53,450.0</td>
<td>10,000</td>
<td>44,000</td>
<td>10,000</td>
<td>114,000</td>
</tr>
<tr>
<td>FY2010 (初值)</td>
<td>22,294.0</td>
<td>53,450.0</td>
<td>10,000</td>
<td>44,000</td>
<td>10,000</td>
<td>114,000</td>
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**<Obligations by Financing Methods>**

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<th>基建债券</th>
<th>特种财政融资债券</th>
<th>再融资债券</th>
<th>FILP债券</th>
<th>总计</th>
</tr>
</thead>
<tbody>
<tr>
<td>百亿元</td>
<td>112,300.0</td>
<td>121,500.0</td>
<td>50,000</td>
<td>144,300.0</td>
<td>10,000</td>
<td>458,800.0</td>
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<tr>
<td>FY2009 (初值)</td>
<td>112,300.0</td>
<td>121,500.0</td>
<td>50,000</td>
<td>144,300.0</td>
<td>10,000</td>
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<tr>
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<td>144,300.0</td>
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<td>458,800.0</td>
</tr>
<tr>
<td>FY2010 (初值)</td>
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<td>121,500.0</td>
<td>50,000</td>
<td>144,300.0</td>
<td>10,000</td>
<td>458,800.0</td>
</tr>
</tbody>
</table>

**Note:** Figures may not sum up to total because of rounding.

**Note:** JGB Market Issuance (Calendar Base) refers to JGBs issued by scheduled auctions from April to next March.

**Note:** Figures may not sum up to total because of rounding.

**Note:** The maximum amount of front-loaded issuance of Refunding bonds in FY2010 is 12 trillion yen.

Non-price competitive auction II is an auction carried out after the price-competitive auction. The price offered is equal to the weighted average accepted price in the price-competitive auction. Only the JGB Market Special Participants are eligible to bid in this auction (the amount assignable to each Market Special Participant will not exceed 15% of the amount awarded to it in the price-competitive auction).

Non-price competitive auction II is estimated at 3.75% of the JGB Market Issuance excluding TBs and bonds issued in Auctions for Enhanced-liquidity.

**Note:** Figures may not sum up to total because of rounding.

**Note:** The total Buy-back amount from the market will be 3 trillion yen in FY2010, continuously focusing on the 10-year Inflation-Indexed bonds and 15-year Floating-rate bonds (details will be decided on a quarterly basis taking in the market conditions).
Market Issuance Plan by JGB Types

**Market Issuance Plan by JGB Types**

- **Note 1:** Special Participants after the price-competitive auction (the amount assignable to each Market Special Participant will not exceed 15% of the amount awarded to it in the price-competitive auction).
- **Note 2:** The issuance of the 15-year Floating-rate bonds and 10-year Inflation-Indexed bonds in FY2010 could be called off, taking into the market conditions.
- **Note 3:** In addition to the above plan, 40-year, 30-year, 20-year, 10-year, 5-year, 2-year, 15-year Floating-rate and 10-year Inflation-Indexed bonds will be issued via Non-price competitive auction II, which will be held for JGB Market Special Participants.
- **Note 4:** Short-term (Treasury Bills) 2-~6-year 20-year, 30-year, 40-year 10-year JGBs i.

### Market Issuance Plan by JGB Types

#### FY2009 (Initial)

- **40-year**
  - 0.6 × 4 times 0.6
  - 0.0 × 2 times 0.0
- **30-year**
  - 0.0 × 5 times 0.0
  - 0.0 × 3 times 0.0
- **20-year**
  - 0.0 × 12 times 0.0
  - 0.0 × 9 times 0.0
- **10-year**
  - 1.0 × 12 times 1.0
  - 0.5 × 4 times 0.5
- **5-year**
  - 2.0 × 12 times 2.0
  - 2.0 × 6 times 2.0
- **2-year**
  - 0.0 × 12 times 0.0
  - 0.0 × 6 times 0.0

#### FY2009 (2nd Supplementary budget)

- **40-year**
  - 0.6 × 4 times 0.6
  - 0.0 × 2 times 0.0
- **30-year**
  - 0.0 × 5 times 0.0
  - 0.0 × 3 times 0.0
- **20-year**
  - 0.0 × 12 times 0.0
  - 0.0 × 9 times 0.0
- **10-year**
  - 1.0 × 12 times 1.0
  - 0.5 × 4 times 0.5
- **5-year**
  - 2.0 × 12 times 2.0
  - 2.0 × 6 times 2.0
- **2-year**
  - 0.0 × 12 times 0.0
  - 0.0 × 6 times 0.0

#### FY2010 (Initial)

- **40-year**
  - 0.6 × 4 times 0.6
  - 0.0 × 2 times 0.0
- **30-year**
  - 0.0 × 5 times 0.0
  - 0.0 × 3 times 0.0
- **20-year**
  - 0.0 × 12 times 0.0
  - 0.0 × 9 times 0.0
- **10-year**
  - 1.0 × 12 times 1.0
  - 0.5 × 4 times 0.5
- **5-year**
  - 2.0 × 12 times 2.0
  - 2.0 × 6 times 2.0
- **2-year**
  - 0.0 × 12 times 0.0
  - 0.0 × 6 times 0.0

#### FY2009 (Initial)

- **40-year**
  - 0.6 × 4 times 0.6
  - 0.0 × 2 times 0.0
- **30-year**
  - 0.0 × 5 times 0.0
  - 0.0 × 3 times 0.0
- **20-year**
  - 0.0 × 12 times 0.0
  - 0.0 × 9 times 0.0
- **10-year**
  - 1.0 × 12 times 1.0
  - 0.5 × 4 times 0.5
- **5-year**
  - 2.0 × 12 times 2.0
  - 2.0 × 6 times 2.0
- **2-year**
  - 0.0 × 12 times 0.0
  - 0.0 × 6 times 0.0

**Note:** FY1997-2009: Actual figures.
Guiding Principles

◆ Predictability
The JGB issuance plan for the fiscal year is to be formulated and announced at the end of the previous year, which provides market participants with the predictability for the market issuance.

◆ Transparency
The JGB issuance plan is to be formulated in consultation with the market participants, including primary dealers and investors, so that the plan reflects market needs properly. The record of such consultation is made public on the JGB web-pages.

◆ Flexibility
Responding to the change of the market conditions after the formulation of annual issuance plan, the issuance authority flexibly reviews and revises the annual plan based on close consultations with the market participants.

Dialogue with the Markets

- The Meeting of JGB Market Special Participants
  - Share ideas with major banks and securities companies (Primary Dealers)

- The Meeting of JGB Investors
  - Dialogue with institutional investors such as insurance companies, pension funds, banks and foreign investors

- The Advisory Council on Government Debt Management
  - Obtain opinions and advice on the government debt management policy from intellectuals in the private sector

- Promotion of JGB holdings

- Overseas IR
  - Explain the current status and future direction of the Japanese economy, debt management policies, etc directly to foreign investors

- The Meeting of JGB Top Retailers
  - Dialogue with financial institutions involving actively in promotion for retail JGB holdings
JGB Market Special Participants

MOF grants privileges to qualified auction participants in return for fulfilling responsibilities.

<table>
<thead>
<tr>
<th>Privileges</th>
<th>Responsibilities</th>
</tr>
</thead>
<tbody>
<tr>
<td>(1) Participation in regular meetings</td>
<td>(1) Bidding obligation (min. 3% in every auction)</td>
</tr>
<tr>
<td>(2) Participation in buy-back auctions</td>
<td>(2) Successful bids target (target min. 1%* in per quarter in each category)</td>
</tr>
<tr>
<td>(3) Stripping and reconstruction operations of STRIPS</td>
<td>* 0.5% for short-term instruments</td>
</tr>
<tr>
<td>(4) Participation in Non-Price Competitive Auction</td>
<td>(3) Improving and maintaining liquidity in the secondary market</td>
</tr>
<tr>
<td>(5) Participation in Auction for Enhanced-Liquidity</td>
<td>(4) Information sharing</td>
</tr>
<tr>
<td>(6) Preferred participation in interest rate swap transactions</td>
<td></td>
</tr>
</tbody>
</table>

Regular Business Cycle

- **[Nov.- Dec.]** Consultation with the market participants, including Primary Dealers and investors, for the purpose of formulating JGB Issuance Plan of the next fiscal year
- **[End of Dec.]** Cabinet decision of next fiscal year’s budget
  - Announcing JGB total issuance amount (with breakdown figures by the fiscal needs, and by the financing methods) and JGB market issuance by JGB Types
- **[End of Mar.]** Diet approval of the next fiscal year’s regular budget
  - Confirmation of JGB Issuance plan
  - Throughout a fiscal year, consultation with the market participants takes place at least quarterly.
- **[About 3 months before]** Announcement of auction dates
- **[About 1 week before]** Announcement of auction dates, issuance dates, maturities and offering amounts
- **[Day of Auction]**
  - 10:30 Announcement of detail information (including coupon rates)
  - 12:00 Closing of the auction
  - 12:45 Announcement of the auction results
  - 16:00 Official notification to bidders

JGB Issuance
II. Market Development

Syndicate Underwriting System

Syndicate underwriting system is a mechanism wherein a group of selected financial institutions underwrite JGB issuances with negotiated terms. This system has contributed stable consumption of JGBs in early days. However, in light of enhancing market price mechanism, the share of syndicate underwriting has been reduced over time, and eventually abolished.

- **100% fixed-share underwriting (Jan.1966-Oct.1987)**
  - Fixed-share underwriting (100%)

- **Auction on an underwriting basis (Nov.1987-March1989)**
  - Fixed-share underwriting (80%)
  - Auction on an underwriting basis

  - Fixed-share underwriting
  - Competitive price auction (90%)

- **Abolishment of the syndicate underwriting (at the end of Mar.2006)**
  - Competitive price auction (100%)
Development of Secondary Market

**Market Participation**
- **Apr. 1977**: Starting of secondary market transactions
- **Apr. 1983**: Starting of retail trading by financial institutions (34 banks; City Banks etc)

**Market Diversifying**
- **Oct. 1985**: Starting of futures contracts
- **May. 1990**: Starting of option contracts
- **Apr. 1996**: Starting of repo contracts

**Expansion**
- **Oct. 1984**: Foreign banks
- **Jul. 1985**: Regional banks
- **Jul. 1986**: Credit union (Shinkin bank)
- **Apr. 1988**: Postal office

**Auction Mechanism**

**Offering Amount**: 1,500 bln yen

<table>
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<tr>
<th>Bid Price</th>
<th>Bid Amount</th>
<th>Subtotal</th>
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<td>200 bln yen</td>
<td>300</td>
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<tr>
<td>100.00</td>
<td>400 bln yen</td>
<td>700</td>
</tr>
<tr>
<td>99.95</td>
<td>600 bln yen</td>
<td>1,380</td>
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<tr>
<td>99.90</td>
<td>400 bln yen</td>
<td>780</td>
</tr>
<tr>
<td>99.85</td>
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<tr>
<td>99.80</td>
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<td>2,350</td>
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<tr>
<td>99.75</td>
<td>200 bln yen</td>
<td>2,550</td>
</tr>
<tr>
<td>99.70</td>
<td>50 bln yen</td>
<td>2,600</td>
</tr>
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</table>

- **Bid to cover ratio**: Amounts of competitive bids / amounts of bids accepted. In this example, 1.7 (2,600 / 1,500).
- **Tale**: Weighted average price — lowest accepted price. In this example, tale is 0.19 (100.10 - 99.91).

※1. Applied in 40-year and JGBs
※2. The lowest bids are allotted on pro-rata basis among the relevant bidders.
WI (When Issued) Transaction

- Publication of all necessary information enabled the market to further extend WI transactions prior to the days of auction (since February, 2004).
- WI transaction allows both market participants and the issuing authority to grasp market trends in a more timely fashion.

Recent Auction Results

(Note) The data is based on 2-year, 5-year, 10-year, 20-year and 30-year bonds.
Yield Curves

As of Nov. 18

(%) 3M 6M 1Y 2Y 3Y 4Y 5Y 6Y 7Y 8Y 9Y 10Y 15Y 20Y 30Y 5Y 10Y 20Y 30Y 40Y
Source: Bloomberg

JGB Yield Spreads

As of Nov. 18

(%) 0.0 0.1 0.2 0.3 0.4 0.5 0.6 0.7 0.8 0.9
(Source) Bloomberg
Yield Spreads between JGBs and Other Government Bonds

2-year

10-year

Comparison of Yield Spreads (10-30 year)
**Interest Rate of 10-year Bonds and 10-year Inflation-Indexed Bonds, and the BEI rate**

![Graph showing the interest rate of 10-year Bonds and 10-year Inflation-Indexed Bonds, and the BEI rate.]

**Market Size of 10-year Inflation-indexed Bonds**

**Total issue size of 10-year Inflation-indexed Bonds (Calendar Base)**

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<tbody>
<tr>
<td>¥0.1 tr.</td>
<td>¥0.8 tr.</td>
<td>¥2.0 tr.</td>
<td>¥2.5 tr.</td>
<td>¥3.0 tr.</td>
<td>¥3.0 tr.</td>
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<tr>
<td>FY2008 (revised in Sep.)</td>
<td>FY2008 (revised in Oct.)</td>
<td>FY2008 (Initial)</td>
<td>FY2008 (revised in Oct.)</td>
<td>FY2008 (Initial)</td>
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<td>¥2.8 tr.</td>
<td>¥2.0 tr.</td>
<td>¥1.5 tr.</td>
<td>¥0.3 tr.</td>
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<td>¥0.3 tr.</td>
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**Buy-back amount of 10-year Inflation-indexed Bonds**

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<td>¥0.05 tr.</td>
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<td>¥0.84 tr.</td>
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<td>FY2008</td>
<td>FY2009</td>
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<td>¥1.49 tr.</td>
<td>¥2.82 tr.</td>
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**Outstanding amount of 10-year Inflation-indexed Bonds**

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<td>¥0.1 tr.</td>
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<td>¥3.0 tr.</td>
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<td>¥6.4 tr.</td>
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<th>Jun 2010</th>
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<td>¥5.8 tr.</td>
<td>¥9.3 tr.</td>
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Interest Rate of 10-year Bonds and 15-year Floating-rate Bonds

(Note) Issue α: decided at auctions.

Market Size of 15-year Floating-rate Bonds

<table>
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<th>Total issue size of 15-year Floating-rate Bonds (Calendar Basis)</th>
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<td>--------</td>
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<tr>
<td>¥9.0 trl.</td>
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<td>¥2.4 trl.</td>
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Buy-back amount of 15-year Floating-rate Bonds

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<td>¥0.17 trl.</td>
<td>¥0.48 trl.</td>
<td>¥1.2 trl.</td>
<td>¥1.4 trl.</td>
<td>¥1.5 trl.</td>
<td>¥1.5 trl.</td>
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<td>¥1.28 trl.</td>
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Outstanding amount of 15-year Floating-rate Bonds

<table>
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<tbody>
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<td>¥17.9 trl.</td>
<td>¥25.3 trl.</td>
<td>¥34.2 trl.</td>
<td>¥39.6 trl.</td>
<td>¥42.7 trl.</td>
<td>¥41.9 trl.</td>
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<tr>
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<td>Jun 2010</td>
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<td></td>
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<tr>
<td>¥46.6 trl.</td>
<td>¥46.3 trl.</td>
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Sovereign CDS Spreads (5-year)

As of Nov. 18

Greece 970
Portugal 409
Ireland 504
Spain 258
Italy 180
U.K. 61
Japan 58
U.S. 39
Germany 38

III. Recent Initiatives
Liquidity Control Measures

Buy-Back Operation
Absorb less transacted issues.

Debt Management Office

Regular Redemption

Market

Regular Issuance

Auction for Enhanced-Liquidity
Expand the volumes of issues with liquidity constraints.

Auction for Enhanced Liquidity

- Remaining maturity: 5~6 years
- 20-year bond

- Remaining maturity: 15~30 years
- 20-year bond

- Remaining maturity: 35~40 years
- 30-year bond

- Remaining maturity: 45~50 years
- 40-year bond

Issues amount and frequency per month

- 600 billion yen
- Frequency per month (150 billion yen × 2)

- 200 billion yen
- Frequency per month (100 billion yen × 2)

- 100 billion yen
- Frequency per month (×1)

- 600 billion yen
- Frequency per month (300 billion yen × 2)

- Issues amount and frequency per month

- Frequency per month (150 billion yen × 2)

- Frequency per month (100 billion yen × 2)

- Frequency per month (×1)

Issues amount and frequency per month

- Frequency per month (150 billion yen × 2)

- Frequency per month (100 billion yen × 2)

- Frequency per month (×1)

Lehman Brothers' bankruptcy
(Deepening financial crisis)
Issuance amount and frequency per month
raised total market issuance amount responding to the formulation of the stimulus package
+ 16.9 trillion
Auction for Enhanced Liquidity (Cont’d)

① Remaining maturity: approx. 5~15-year (billion yen)
10-year 20-year
② Remaining maturity: approx. 15~29-year (billion yen)
20-year 30-year

Buy-Back Operation

(Note1) The bonds listed below are excluded from the buy-back program
1. 40-year JGBs
2. JGBs with remaining maturities equal to or less than 1 year
3. JGBs that have been successfully bid through the Auctions of Enhanced Liquidity during the recent 6 months before the buy-back month.
4. non-marketable bonds.

(Note2) Figures in the chart are actual.
Buy-Back Operation (Cont’d)

(Note) Figures based on the initial plan

- Auction Month | FY2009 | FY2010
- 10-year Floating-rate | 31-year Inflation-indexed | STRIPS (Coupon) | 10-year Floating-rate | 31-year Inflation-indexed | STRIPS (Coupon)
- Apr | Approx. 100 | Approx. 220 | — | Approx. 80 | Approx. 180 | —
- May | Approx. 140 | Approx. 220 | — | Approx. 80 | Approx. 90 | —
- Jun | Approx. 100 | Approx. 220 | — | Approx. 80 | Approx. 180 | —
- Jul | Approx. 120 | Approx. 220 | — | Approx. 80 | Approx. 100 | —
- Aug | Approx. 80 | Approx. 240 | — | Approx. 80 | Approx. 200 | —
- Sep | Approx. 120 | Approx. 220 | — | Approx. 80 | Approx. 100 | —
- Oct | Approx. 100 | Approx. 240 | — | Approx. 80 | Approx. 120 | —
- Nov | Approx. 120 | Approx. 200 | — | Approx. 80 | Approx. 80 | —
- Dec | Approx. 100 | Approx. 240 | — | Approx. 70 | Approx. 120 | —
- Jan | Approx. 100 | Approx. 200 | — | Approx. 80 | Approx. 120 | —
- Feb | Approx. 100 | Approx. 200 | — | Approx. 80 | Approx. 60 | —
- Mar | Approx. 100 | Approx. 200 | — | Approx. 70 | Approx. 120 | —
- Total | Approx. 1,280 | Approx. 2,620 | — | Approx. 3,900 | Approx. 800 | —

To be conducted, responding to the market needs.

Actual amount will be decided on a quarterly basis taking into account the market conditions.

Total amount for FY2010

Allocation

40

41

21
Breakdown of JGB Holders

The end of Mar. 2004

Total 569.5 trillion yen

(Note) "Banks, etc." include securities investment trust and securities companies.
From preliminary figures of the end of December 2007: "Banks, etc." includes Postal Saving and
"Life and Nonlife Insurance" includes Postal Life Insurance.
(Source) Bank of Japan, "Flow of Funds"

Foreign Investors’ Holding

(Source) Bank of Japan, "Flow of Funds"
JGB IR Tours

MOF started overseas JGB IR tours in Jan. 2005, and is regularly holding seminars and individual meetings around the world.

Europe
- London (8),
- Edinburgh (1),
- Glasgow (1),
- Amsterdam (3),
- Paris (5),
- Frankfurt (5),
- Milan (1),
- Luxembourg (1),
- The Hague (2)

Scandinavia / Russia
- Copenhagen (2), Stockholm (2), Oslo (2),
- Moscow (1)

Middle East
- Doha (3), Kuwait (4), Riyadh (4),
- Abu Dhabi (4), Dubai (2)

Asia / Oceania
- Hong Kong (4), Singapore (5),
- Sydney (3), Brisbane (1),
- Melbourne (1), Bangkok (1)

North America
- New York (6),
- Minneapolis (1),
- Chicago (2),
- Washington D.C. (1),
- Boston (5),
- San Francisco (3),
- Los Angeles (4),
- Greenwhich (3),
- Toronto (3),
- Ottawa (1)

Zeist (1)

* The numbers inside the brackets mean the number of visits.

Outline of FY2010 Tax Reform
- Simplification of procedure for tax exemption -

Before

Relevant tax office for BOJ

- Written application for tax exemption
- Application for QFI approval
- Statements of the holding period
- Bank of Japan (Issuer - Book-entry transfer institution)
- Sub-custodians
- Individual records of beneficial owner
- Global custodians (QFI)

Non-resident investors

After

Relevant tax office for BOJ

- Written application for tax exemption
- Application for QFI approval
- Payment records of interest
- Bank of Japan (Issuer - Book-entry transfer institution)
- Sub-custodians
- Information on Interest recipient
- Global custodians (QFI)

Non-resident investors

(Note 1) Global custodians have to submit Information on Interest recipient to sub-custodians with the least delay after the time of interest payment.

(Note 2) This rule shall apply to interest on bonds in book-entry form whose coupon calculation period starts on or after June 1, 2010 in principle.
Outline of FY2010 Tax Reform
- Widening of scope of non-taxable entities -

Before

After

① Japan

Distribution
Tax-exempt
JGB
Domestic Securities Company
Resident Investors
Public offering

② Japan

Distribution
Tax-exempt
JGB
Foreign Securities Investment Trust
Non-resident Investors
Public offering

Foreign Securities
Investment Trust
JGB
Distribution
Non-resident Investors
Public offering

JGB for Retail Investors

<table>
<thead>
<tr>
<th></th>
<th>Fixed-Rate (3-year)</th>
<th>Fixed-Rate (5-year)</th>
<th>Floating-Rate (10-year)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Purchasers</td>
<td>Face value: 100 yen, Minimum purchase: 10,000 yen</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Coupon payment</td>
<td>Fixed-rate coupon (Every 6 months)</td>
<td>Fixed-rate coupon (Every 6 months)</td>
<td>Floating-rate coupon (semiannually variable) (Every 6 months)</td>
</tr>
<tr>
<td>Interest rate</td>
<td>Reference rate - 0.03%</td>
<td>Reference rate - 0.05%</td>
<td>Reference rate - 0.8%</td>
</tr>
<tr>
<td>Guaranteed minimum interest rate</td>
<td>0.05%</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Redemption before maturity</td>
<td>Possible after 1 year</td>
<td>Possible after 2 years</td>
<td>Possible after 1 year</td>
</tr>
<tr>
<td>Value for redemption before maturity</td>
<td>Face value + a proportionate amount of accrued interest – already paid interest to a value corresponding to 2 interest payments (before tax) × 0.8</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Face value + a proportionate amount of accrued interest – already paid interest to a value corresponding to 4 interest payments (before tax) × 0.8</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Face value + a proportionate amount of accrued interest – already paid interest to a value corresponding to the most recent 2 interest payments (before tax) × 0.8</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Frequency of issuance</td>
<td>Monthly</td>
<td>Quarterly</td>
<td></td>
</tr>
</tbody>
</table>
Cost-at-Risk Analysis

- Cost-at-Risk (CaR) analysis is a simulation method to estimate the possible maximum amount of interest payments over the next 10 years to 50 years.
- Future yield curve scenarios (paths) are generated by a stochastic interest rate model.
- Cost and risk are estimated by a stochastic distribution of future interest payments generated by simulations.
Cost-at-Risk Analysis (Cont’d)

- There is generally a trade-off between the minimizations of financing cost and risk of interest fluctuation, and therefore, the question for the debt managers is where to take the balance between these 2 factors.
- CaR analysis can suggest several patterns as to how the current distribution among maturities may be shifted for future years depending on what the focus of the debt management would be.

Annex
Japanese Economic /Fiscal Profile

“New Growth Strategy”
(Cabinet Decision / National Policy Unit, 2010.6.18)

 Targets by 2020:
① Push up CPI to positive range in FY2011.
② Achieve average GDP growth: nominal 3%, real 2%.
③ Lower the unemployment rate to 3% - 4% at the earliest possible timing.

7 strategic areas & 21 national strategic projects

<table>
<thead>
<tr>
<th>Green Innovation</th>
<th>Life Innovation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Asia</td>
<td>Tourism-oriented nation &amp; local revitalization</td>
</tr>
<tr>
<td>Science-and-technology</td>
<td>IT oriented nation</td>
</tr>
<tr>
<td>Employment &amp; human resources</td>
<td>Financial sector</td>
</tr>
</tbody>
</table>

Creation of new demand and jobs

<table>
<thead>
<tr>
<th>Area</th>
<th>Demand creation</th>
<th>Job creation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Environment (Green Innovation)</td>
<td>$50 trillion</td>
<td>1.4 million jobs</td>
</tr>
<tr>
<td>Health (Life Innovation)</td>
<td>$50 trillion</td>
<td>2.4 million jobs</td>
</tr>
<tr>
<td>Asia</td>
<td>$12 trillion</td>
<td>190,000 jobs</td>
</tr>
<tr>
<td>Tourism</td>
<td>$11 trillion</td>
<td>560,000 jobs</td>
</tr>
</tbody>
</table>
“Fiscal Management Strategy” (Cabinet Decision, 2010.6.22)

Flow

Aggregate Primary Balance Deficit

<table>
<thead>
<tr>
<th>Year</th>
<th>Deficit</th>
</tr>
</thead>
<tbody>
<tr>
<td>FY 2010</td>
<td>-6.4%</td>
</tr>
<tr>
<td>2015</td>
<td>-3.2%</td>
</tr>
<tr>
<td>2020</td>
<td>0%</td>
</tr>
</tbody>
</table>

Stock

Public debt ratio can only improve after flow targets are met.

- Stable reduction of public debt ratio to GDP in and after 2021

The major ones
- Public Works 5,773.1
- Education & Science 5,586.0
- National Defense 4,790.3

Total Expenditures 92,299.2 (100.0%)

Refund to the Settlement Adjustment Fund 718.2 0.8%

Primary Balance

Revenues 75,931.9 76.8%
Expenditures 61,606.8 66.8%

Bond Revenues
Interest payments
Debt redemption
Refund to the Settlement Adjustment Fund
Tax Revenues
Expenditures

(Unit: billion yen, %)
“Fiscal Management Strategy”
(Cabinet Decision, 2010.6.22)

Basic rules on fiscal management

1. Pay-as-you-go rule
   Whenever policies that increase expenditure or reduce revenue are introduced, stable revenue sources must be secured by permanent reductions in expenditures or revenue-raising measures.

2. Fiscal deficit reduction rule
   Fiscal condition must be steadily improved each year in order to achieve the flow targets.

3. Securing revenue sources for structural expenditures
   Stable revenue shall be secured for structural expenditures such as social security costs required for pension and medical and care-giving benefits.

4. Basic principles for reviewing expenditure
   Eliminate any unnecessary expenditure including those of the Special Accounts and drastically restructure the budget.

5. Stable management of local government finance
   Both national and local governments will take measures for fiscal consolidation in mutual cooperation. The national government will not implement measures which transfers burden to local governments and hinders its autonomy.

Expenditure side

- FY2011—FY2013 Primary Balance Expenses shall be kept lower than 71 trillion yen (in substantial terms)

Revenue side

- Determine the details of the comprehensive reform of taxes including personal income tax, corporate tax, consumption tax and tax on assets, as soon as possible.

Bond issuance

- FY2011 around 44 trillion yen (= FY2010)
- Steadily decrease after FY 2011
Annex 2. Economic Indicators

Changes in GDP Growth Rate

(Source: Cabinet office)
Japanese Economic Outlook

<table>
<thead>
<tr>
<th>(% Change from the previous year)</th>
<th>FY2009</th>
<th>FY2010</th>
<th>FY2011</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cabinet Office - Economic Outlook (January 2010)</td>
<td>Real GDP</td>
<td>-2.6</td>
<td>1.4</td>
</tr>
<tr>
<td>Bank of Japan - Forecast of the Majority of Policy Board Members (October 2010)</td>
<td>Real GDP</td>
<td>-2.2</td>
<td>2.1</td>
</tr>
</tbody>
</table>

(% change from the previous year)

<table>
<thead>
<tr>
<th>(% Change from the previous year)</th>
<th>CY2009</th>
<th>CY2010</th>
<th>CY2011</th>
</tr>
</thead>
<tbody>
<tr>
<td>IMF - World Economic Outlook (October 2010)</td>
<td>Real GDP</td>
<td>-5.2</td>
<td>2.8</td>
</tr>
<tr>
<td>OECD - Economic Outlook (May 2010)</td>
<td>Real GDP</td>
<td>-5.2</td>
<td>3.7</td>
</tr>
</tbody>
</table>
Global Economic Outlook for CY2008 - 2011

<table>
<thead>
<tr>
<th></th>
<th>2008</th>
<th>2009</th>
<th>2010</th>
<th>2011</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Actual</td>
<td>Actual</td>
<td>Actual</td>
<td>Actual</td>
</tr>
<tr>
<td>Japan</td>
<td>-1.2</td>
<td>-5.2</td>
<td>1.7</td>
<td>1.9</td>
</tr>
<tr>
<td></td>
<td>2.4</td>
<td>2.8</td>
<td>2.0</td>
<td>1.8</td>
</tr>
<tr>
<td>United States</td>
<td>0</td>
<td>-2.6</td>
<td>2.7</td>
<td>3.1</td>
</tr>
<tr>
<td></td>
<td>3.3</td>
<td>2.6</td>
<td>2.6</td>
<td>2.9</td>
</tr>
<tr>
<td>Euro Area</td>
<td>0.5</td>
<td>-4.1</td>
<td>1.0</td>
<td>1.0</td>
</tr>
<tr>
<td></td>
<td>1.0</td>
<td>1.7</td>
<td>1.5</td>
<td>1.3</td>
</tr>
<tr>
<td>United Kingdom</td>
<td>-0.1</td>
<td>-4.9</td>
<td>1.3</td>
<td>1.3</td>
</tr>
<tr>
<td></td>
<td>1.2</td>
<td>1.7</td>
<td>2.5</td>
<td>2.1</td>
</tr>
<tr>
<td>Advanced economies</td>
<td>0.2</td>
<td>-3.2</td>
<td>2.1</td>
<td>2.3</td>
</tr>
<tr>
<td></td>
<td>2.6</td>
<td>2.7</td>
<td>2.4</td>
<td>2.2</td>
</tr>
<tr>
<td>Developing economies</td>
<td>6.0</td>
<td>2.5</td>
<td>6.0</td>
<td>6.3</td>
</tr>
<tr>
<td></td>
<td>6.8</td>
<td>7.1</td>
<td>6.5</td>
<td>6.4</td>
</tr>
<tr>
<td>Developing Asia</td>
<td>7.7</td>
<td>6.9</td>
<td>8.4</td>
<td>8.7</td>
</tr>
<tr>
<td></td>
<td>9.2</td>
<td>9.4</td>
<td>8.7</td>
<td>8.5</td>
</tr>
<tr>
<td>China</td>
<td>9.6</td>
<td>9.1</td>
<td>10.0</td>
<td>10.0</td>
</tr>
<tr>
<td></td>
<td>10.5</td>
<td>10.5</td>
<td>9.9</td>
<td>9.6</td>
</tr>
<tr>
<td>World</td>
<td>2.8</td>
<td>-0.6</td>
<td>3.9</td>
<td>4.2</td>
</tr>
<tr>
<td></td>
<td>4.6</td>
<td>4.8</td>
<td>4.3</td>
<td>4.3</td>
</tr>
<tr>
<td></td>
<td>4.2</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

(source) IMF - World Economic Outlook (July 2010)

Price Trends

[Corporate Goods Price Index and Consumer Price Indices]

(Source: Ministry of Internal Affairs and Communications, Bank of Japan)
Exports Volume Index

(Source) Ministry of Finance (three month’s moving average)

Employment

(Source) Ministry of Internal Affairs and Communications, Ministry of Health, Labour and Welfare

Seasonally adjusted

Unemployment rate (left scale)

Ratio of effective job openings to applicants (right scale)
### Compensation for Employees

(billion yen) Seasonally adjusted, at current prices

![Graph showing Compensation for Employees](image)

(Source) Cabinet Office

### Current Account

![Graph showing Current Account](image)

(Source) Ministry of Finance
Losses from the Current Financial Market Turmoil

(Source) Bloomberg (March 4, 2010)
(Note) The losses include not only realized losses but also valuation losses.

Changes in the Outstanding Amount of NPLs of the Major Japanese Banks

(Unit: trillion yen) (%)
Trends in the US House Prices and Japan’s Land Prices

(Source: MLIT (Japan), S&P Case-Shiller Home Price Indices (US); Halifax House Price Index (UK))

(Note 1) Japan’s posted land prices are those in the largest three areas; Tokyo, Osaka and Nagoya.
(Note 2) US house prices are those in the main ten cities; Los Angeles, San Diego, San Francisco, Denver, Washington D.C., Miami, Chicago, Boston, Las Vegas and New York.
(Note 3) UK house prices are the nation prices.

Policy Interest Rate

(Source: Central Banks)

- Target range for the Federal funds rate (FRB)
- Main refinancing operations of the Eurosystem (ECB)
- Basic loan rate (BOJ)
- Target for the uncollateralized overnight call rate (BOJ)
- Uncollateralized overnight call rate

Policy Interest Rate of Major Countries after Lehman Brothers’ Bankruptcy

- FRB: 10/8 10/29 12/16
  - 1.50% → 1.00% → 0.25%
- ECB: 10/8 11/6 12/4 1/15 3/5 4/2 5/7
  - 3.75% → 3.25% → 2.50% → 2.00% → 1.50% → 1.25% → 1.00%
- BOE: 10/8 11/6 12/4 1/8 2/5 3/5
  - 4.50% → 3.00% → 2.00% → 1.50% → 1.00% → 0.50%

Oct. 5, 2010
Monetary Policy Meeting
BOJ encouraged the uncollateralized overnight call rate to remain at around 0 to 0.1 percent.

Mar. 9, 2006
Monetary Policy Meeting
Lift the quantitative easing

Jul. 14, 2006
Monetary Policy Meeting
- Lift the zero interest rate → 0.25%
- Raise basic loan rate 0.1% → 0.4%

Feb. 21, 2007
Monetary Policy Meeting
- Rate rise 0.25% → 0.50%
- Raise basic loan rate 0.4% → 0.75%

Oct. 31, 2008
Monetary Policy Meeting
- Lowering of target rate 0.50% → 0.30%
- Lowering of basic loan rate 0.75% → 0.50%

Dec. 19, 2008
Monetary Policy Meeting
- Lowering of target rate 0.30% → 0.10%
- Lowering of basic loan rate 0.50% → 0.30%
Trends in Stock Prices since 1985

Nikkei 225

(Source) Bloomberg

Trends in USD-JPY Exchange Rates since 1985

(Source) Bloomberg
Annex 3. Fiscal Figures

FY2010 Japan’s Fiscal Condition
(Trends in General Account Tax Revenues, Total Expenditures, and Government Bond Issues)

<table>
<thead>
<tr>
<th>Year</th>
<th>General Account Primary Balance</th>
<th>Bond Dependency Ratio</th>
</tr>
</thead>
<tbody>
<tr>
<td>FY2010</td>
<td>-23.7 trillion yen</td>
<td>48.0%</td>
</tr>
</tbody>
</table>

Government Bonds Outstanding (General Bonds Outstanding): Approx. 6.37 trillion (134%)
Long-term Debt Outstanding of Central and Local Governments: Approx. 8.62 trillion (181%)

Total Expenditures
Tax Revenues
Construction Bonds Issues
Special Deficit-Financing Bonds Issues

(Note 1) FY1975-2008: Settlement; FY2009: Second revised budget; FY2010: Initial Budget
(Note 2) The special deficit-financing bonds outstanding include refunding bonds for long-term debts transferred from JR Settlement Corporation, National Forest Service, etc.
(Note 3) General Account Primary Balance is calculated based on the easy-to-use method of National Debt Service minus Government Bond Issues, and is different from the Central Government Primary Balance in the SNA sense.)
Long-Term Debt Outstanding of Both Central and Local Governments

Outstanding JGBs

Figures are based on nominal amount.
International Comparison of Value-Added Tax Rates (Standard Tax Rate)

(As of January 2010)

(Notes) 1. In Japan, the consumption tax rate includes the rate of Local Consumption Tax (1% out of 5%).
2. Prepared from the OECD’s “European Taxation Database”, an interview survey that targeted the embassies of each country, and the national tax authorities of each country.

International Comparison of National Burden Ratio as a Percentage of National Income

(As a percent of NI: %)

[National Burden Ratio = Total Taxes as a percentage of National Income (NI) + Social Security Contribution as a percentage of NI]

(Note) The figures are the latest actual results of the 28 OECD-member countries. Turkey and Mexico are excluded because numerical data is insufficient to calculate the national burden ratio.

### International Comparison of Taxpayer Burden of Individual Income Tax

**As of January 2010**

<table>
<thead>
<tr>
<th>Country</th>
<th>Employment income 5 Million yen</th>
<th>Employment income 7 Million yen</th>
<th>Employment income 10 Million yen</th>
</tr>
</thead>
<tbody>
<tr>
<td>Japan</td>
<td>¥73,984</td>
<td>¥80,808</td>
<td>¥93,696</td>
</tr>
<tr>
<td>United States</td>
<td>¥128,500</td>
<td>¥131,000</td>
<td>¥140,000</td>
</tr>
<tr>
<td>United Kingdom</td>
<td>¥179,500</td>
<td>¥180,100</td>
<td>¥193,000</td>
</tr>
<tr>
<td>Germany</td>
<td>¥227,300</td>
<td>¥226,600</td>
<td>¥226,400</td>
</tr>
<tr>
<td>France</td>
<td>¥258,400</td>
<td>¥258,100</td>
<td>¥256,100</td>
</tr>
<tr>
<td>Japan</td>
<td>¥19,500</td>
<td>¥20,400</td>
<td>¥21,500</td>
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<tr>
<td>United States</td>
<td>¥42,100</td>
<td>¥42,000</td>
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<td>¥78,100</td>
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<tr>
<td>Germany</td>
<td>¥136,100</td>
<td>¥136,100</td>
<td>¥136,100</td>
</tr>
<tr>
<td>France</td>
<td>¥131,000</td>
<td>¥131,000</td>
<td>¥131,000</td>
</tr>
<tr>
<td>Japan</td>
<td>¥80,800</td>
<td>¥80,800</td>
<td>¥80,800</td>
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<tr>
<td>United States</td>
<td>¥98,500</td>
<td>¥96,400</td>
<td>¥93,696</td>
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<td>United Kingdom</td>
<td>¥167,200</td>
<td>¥167,200</td>
<td>¥160,100</td>
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<tr>
<td>Germany</td>
<td>¥199,500</td>
<td>¥199,500</td>
<td>¥193,000</td>
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<tr>
<td>France</td>
<td>¥251,000</td>
<td>¥251,000</td>
<td>¥251,000</td>
</tr>
<tr>
<td>Japan</td>
<td>¥113,000</td>
<td>¥113,000</td>
<td>¥113,000</td>
</tr>
</tbody>
</table>

**Notes:**
1. Based on certain assumptions and models for the purpose of international comparison.
2. Exchange rates in this graph are USD1.00 = JPY89, GBP1.00 = JPY148, EUR1.00 = JPY133 (Base exchange rates: Average actual market values during November 2009).

### International Comparison of Effective Corporation Income Tax Rate

**As of January 2010**

<table>
<thead>
<tr>
<th>Country</th>
<th>National Tax</th>
<th>Local Tax</th>
</tr>
</thead>
<tbody>
<tr>
<td>Japan</td>
<td>15.83%</td>
<td>27.89%</td>
</tr>
<tr>
<td>United States</td>
<td>28.00%</td>
<td>13.58%</td>
</tr>
<tr>
<td>Germany</td>
<td>13.58%</td>
<td>8.84%</td>
</tr>
<tr>
<td>France</td>
<td>25.00%</td>
<td>2.20%</td>
</tr>
<tr>
<td>Japan</td>
<td>25.00%</td>
<td>10.76%</td>
</tr>
<tr>
<td>United States</td>
<td>24.20%</td>
<td>21.50%</td>
</tr>
<tr>
<td>Germany</td>
<td>23.00%</td>
<td>25.00%</td>
</tr>
<tr>
<td>France</td>
<td>25.00%</td>
<td>25.00%</td>
</tr>
<tr>
<td>Japan</td>
<td>25.00%</td>
<td>25.00%</td>
</tr>
<tr>
<td>United States</td>
<td>25.00%</td>
<td>25.00%</td>
</tr>
<tr>
<td>Germany</td>
<td>25.00%</td>
<td>25.00%</td>
</tr>
<tr>
<td>France</td>
<td>25.00%</td>
<td>25.00%</td>
</tr>
</tbody>
</table>

**Notes:**
1. The above effective tax rate takes account of the effect that the amount of the local taxes may be deductible in calculating national taxes, etc.
2. Japan's corporation enterprise tax and local special corporate tax use a tax rate that is applied to corporations with capital of 100 million yen or more that are subject to preforms and local taxes. In addition, an added value percentage and capital percentage are also used.
Information

Information Available on MOF Website

<table>
<thead>
<tr>
<th>English Publications on JGBs</th>
<th>Frequency</th>
<th>URL</th>
</tr>
</thead>
<tbody>
<tr>
<td>Debt Management</td>
<td></td>
<td></td>
</tr>
<tr>
<td>JGB Science Plan</td>
<td>As Needed</td>
<td><a href="http://www.mof.go.jp/english/bonds/jarch.htm">http://www.mof.go.jp/english/bonds/jarch.htm</a></td>
</tr>
<tr>
<td>Current Condition of Interest Swap Trading</td>
<td>Unscheduled</td>
<td><a href="http://www.mof.go.jp/english/bonds/swap.htm">http://www.mof.go.jp/english/bonds/swap.htm</a></td>
</tr>
<tr>
<td>Debt Position (Outstanding Debt)</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

About JGBs:

Auction:

Dialogue with Market Participants:
- Minutes of the Meeting of JGB Market Special Participants Each Meeting [※1] http://www.mof.go.jp/english/bonds/meeting.htm

Investor Relations:
- Interest Rate Data Daily http://www.mof.go.jp/english/bonds/interest_rate/detail.htm
- Publications

(note1) Minutes and Debt Management Report need a time lag for translation.
(note2) With the exception of note1, each publications are published real-time i.e. at the same time as Japanese version.
Contacts

- E-mail
  JGB-IR@mof.go.jp

- Address
  3-1-1 KASUMIGASEKI CHIYODA-KU TOKYO
  Debt Management Policy Division
  Financial Bureau
  Ministry of Finance Japan

- Notice service
  We will send a notice to you via e-mail when new information is updated on our website. Please register at, http://www.mof.go.jp/english/ehaisin/etop.htm

Thank You!
ASEAN+3 Bond Market Forum-Korea
- The 2nd ABMF Meeting in Manila -


Suk Hyun
Research Fellow, Ph.D
Korea Capital Market Institute
hyun@kcmi.re.kr

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I. National Working Group: ABMF-Korea

II. Our Vision for the Future
I. National Working Group: ABMF-Korea

1. Structure ABMF-Korea

- MoSF
- ABMF-K
- KCMI (Secretariat)
- Members
- KRX
- KOFIA
- FSS
- KSCC
- BOK

2. Information Collection

- Aim to put together all relevant information in an efficient & objective way
- Deepen discussions on Korean and Asian bond markets development

- ABMF-K
- Public Sectors
- Private Sectors

Main Stakeholders
- KOFIA
- KRX
- KSD
3. Interactive Market-making: Public-Private Partnership (PPP)

- **Korean & Asian Bond Markets Development**
  - Top-down Approach
  - Better Regulation
  - Improve Regulatory Framework

- **Public Sector** (MOSF, BOK, FSC, FSS)

- **ABMF-K** (KCMI)
  - Dialogue Channel
  - Policy Recommendation

- **Market Players**
  - Bottom-up & Market-Driven Approach
  - Utilize the market expertise


- **1st Step**: Common Understanding through knowledge-sharing
  - Collaborate with other Asian countries
  - Close the information gap by facilitating mutual understanding
  - Cooperate to establish Asian standard and harmonization
  - Share our knowledge and experience
    - (Example) KOFIA’s 15 minute reporting rule
II. Our vision for the future

1. Regional Framework for Asian Bond Markets

- **Source:** TA report on Harmonization of Bond Standards in ASEAN+3 of Task Force 3 (TF3).

2. Two Approaches to Rules-setting in cross-border transactions: Statutory Regulation VS Self Regulation

- The ABMF brings together regulators and supervisors as well as market participants to cooperate and exchange information with the aim to harmonize differences in regulatory frameworks.

- **Two theoretical approaches to rule-setting**
  
  A Forum for Regulators, similar to the Committee of European Securities Regulators (CESR), could be established to identify effective regulations that are consistent across jurisdictions.

  A Forum for market participants like International Capital Market Association (ICMA) could also be convened to set regional self-regulatory rules.

- **Two approaches are complementary.**
3. Asian Capital Markets Initiative: Going Beyond Bond Market

- Local Bond Markets (Domestic Bond Market)
  - Circulate domestic savings

- Integrated Asian Bond Market
  - Harmonization of heterogeneous rules and regulations
  - Facilitate inter-regional circulation of savings within Asia

- Equity Market
- Fund Market
- Derivative Market
  etc...

- Harmonization of heterogeneous rules and regulations
- Facilitate inter-regional circulation of savings within Asia

Source: Hyun and Inukai (2010).

Thank you!
Republic of the Philippines’
Peso Global Notes and Multicurrency
Retail Treasury Bonds

Roberto B. Tan
Treasurer of the Philippines

13 December 2010

Global Transaction Highlights

2010

- ROP US$1.5 billion Global Bonds
- ROP Samurai Bonds (US$1.0 billion)
- Retail Treasury Bonds PhP97.5 billion (US$2 billion)
- Multicurrency RTBs US$500 million (including EURO75 million)
- ROP PhP44.109 billion Global Peso Notes (US$1.0 billion)
- ROP USD Bond Exchange (including US$ 200 million new money)
- Domestic Bond Exchange (ongoing)

• Standard & Poor’s credit upgrade on the ROP from BB- to BB.
Peso Global Bonds

Issuer: Republic of the Philippines (“ROP”)
Ratings: Ba3 (Stable) / BB- (stable) / BB (stable)
Issue Type: PHP Global (Denominated in PHP, payable in USD)
Format: SEC Registered
Amount: PHP 44.109 billion (US$1 billion equivalent)
Coupon: 4.950%
Issue Date: 9 Sep 2010
Maturity Date: Jan 15, 2021
PHP FX @ Pricing: 44.109
Yield: 5.000%
Discount to PDST-F: 23%
Issue Price: 99.607

✓ On September 10th, the Republic of the Philippines successfully priced PHP 44.109 billion (USD 1 billion equivalent) Peso Global Bonds due January 2021 at a re-offer yield of 5.00% for a headline coupon of 4.95%.

Pricing was inside the Domestic Sovereign Curve

✓ ROP’s Peso Global Bonds priced favorably vs. the PDST-F benchmark curve
✓ At a yield of 5.00%, the Peso Global Bonds priced at a 23% discount to the 10-year PDST-F curve and inside the 10-year net PDST-F rate of 5.182%
Tremendous Investor Reception led to Huge Orderbook Momentum

Distribution by Geography

Assessing the Overall Objectives of the Transaction

<table>
<thead>
<tr>
<th>Objectives</th>
<th>Outcome</th>
</tr>
</thead>
<tbody>
<tr>
<td>Develop the domestic Government Securities market</td>
<td>The benchmark FOMC rate will remain elevated and remain on the pending</td>
</tr>
<tr>
<td></td>
<td>announcement (28-year fixed rate by about 100 basis points on August 11)</td>
</tr>
<tr>
<td>Increase offshore investor participation in the</td>
<td>90% of the allocation was given to offshore investors and mainly coming</td>
</tr>
<tr>
<td>domestic bond market</td>
<td>by the Feeder funds</td>
</tr>
<tr>
<td>Develop and diversify NIPF’s traditional US bond</td>
<td>Over USD 10 billion was granted to offshore investors and mainly coming</td>
</tr>
<tr>
<td>investor base</td>
<td>by the Feeder funds</td>
</tr>
<tr>
<td>Reduce 50% increasing cost</td>
<td>FPO Capital Reserve priced favourably for the FOMC benchmark and denied</td>
</tr>
<tr>
<td></td>
<td>50% of the allocation was given to offshore investors and mainly coming</td>
</tr>
<tr>
<td></td>
<td>by the Feeder funds</td>
</tr>
<tr>
<td>Improve NIPF’s Profiles</td>
<td>$100 million idle funds over 30 days</td>
</tr>
</tbody>
</table>
ROP Peso Global Bonds Secondary Performance

ROP GPN has tightened significantly in secondary trading and currently trading at 4.15% yield from the issue yield of 5%

Source: Bloomberg, as of 2010 November

ROP Maturity Profile

USD  EUR  JPY  Global PHP
Multicurrency Retail Treasury Bonds (MrTBs) --- Rationale

- OFWs and their families seek safe haven for their hard-earned income

- Historical data show that the level of OFW remittances are recurring and stable

- OFW remittances has a multiplier effect in our economy - triggers increased personal consumption, a beneficiary's propensity to save, and expands the FCDU System's assets

- Eligible Investors
  - Overseas Filipino Workers
  - those immigrant Filipinos who continue to regularly remit to their families to the Philippines
  - Remittance beneficiaries residing in the Philippines, and
  - Trust placements for funds managed in behalf of the entities/persons allowed to invest in the "rTB for OFWs". The Trust department will also certify that their client falls within our definition of allowed holders.
Multicurrency Retail Treasury Bonds (MrTBs)

<table>
<thead>
<tr>
<th>ISSUE SIZE and MINIMUM DENOMINATION</th>
<th>Issue Size</th>
<th>Denomination</th>
</tr>
</thead>
<tbody>
<tr>
<td>USD Tranche</td>
<td>USD500 Million</td>
<td>USD100</td>
</tr>
<tr>
<td>EUR Tranche</td>
<td>EUR100 Million</td>
<td>EUR100</td>
</tr>
</tbody>
</table>

 Aggregate Issue Size of approximately PHP35 Bn based on Nov 18 2009 interbank rates.

MATURETY
Three (3) and Five (5) Years from Issue Date

PRICING
The coupon rate shall be determined via Dutch Auction to be participated in by Government Securities Eligible Dealers ("GSEDs") and shall be benchmarked to the prevailing dollar-denominated bonds issued by the Republic of the Philippines ("RoP").

ELIGIBLE HOLDERS
OFWs and migrant Filipinos including their children, parents, siblings, and allottees

TAXATION ON INTEREST INCOME

| OFWs, migrant Filipinos and their beneficiaries (i.e. parents, siblings, allottees) | Tax-assumed |
| Other Retail Investors | 20% FWT |
| FCDUs and GSEDs | 10% FWT |

Republic's first ever on-shore issuance of government securities denominated in currencies other than the Philippine Peso

Pricing of the MrTBs

The MrTBs priced last 20 April 2010 via Dutch Auction participated by several Government Securities Eligible Dealers ("GSEDs").

PRICING RESULTS

<table>
<thead>
<tr>
<th></th>
<th>US$</th>
<th>Euro</th>
</tr>
</thead>
<tbody>
<tr>
<td>3 year MrTB</td>
<td>2.875%</td>
<td>3.250%</td>
</tr>
<tr>
<td>5 year MrTB</td>
<td>4.125%</td>
<td>4.125%</td>
</tr>
</tbody>
</table>

Total issued amount reached US$500mn of which US$472mn or 94% was sold by the Selling Agents.
Transaction was the first onshore public offering in foreign currency

The MrTBs carried a tax assumption feature for Overseas Filipinos and eligible relatives.

Marketing efforts included a Financial Literacy Briefing spanning 12 cities and a website.

Was priced last 20 April 2010 via Dutch Auction by several Government Securities Eligible Dealers ("GSEDs").

Was offered to the public in a span of eight (8) days from April 20 to 27, 2010.

Moving Forward

• Domestic Bond Exchange (ongoing)
• Global Peso Notes with longer maturity
• Global Dollar to Peso Swap

Complimentary to PPP Program and establishment of Infrastructure Fund
Transaction Results
Total Sales of Selling Agents

<table>
<thead>
<tr>
<th></th>
<th>US $ Tranche Total</th>
<th>Euro Tranche Total</th>
<th>Euro Tranche in US$</th>
<th>In US $ Grand Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Grand Total</td>
<td>371,998,700</td>
<td>74,644,600</td>
<td>100,187,981</td>
<td>472,186,681</td>
</tr>
<tr>
<td>A. Excluded from the Definition of Retail Investors</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1. FCDU</td>
<td>314,106,300</td>
<td>53,771,700</td>
<td>72,172,375</td>
<td>386,278,675</td>
</tr>
<tr>
<td>2. Corporates</td>
<td>14,670,800</td>
<td>5,256,500</td>
<td>7,055,274</td>
<td>21,726,074</td>
</tr>
<tr>
<td>3. TE Is</td>
<td>2,010,000</td>
<td>15,000</td>
<td>10,000</td>
<td>2,030,133</td>
</tr>
<tr>
<td>4. Others</td>
<td>-</td>
<td>10,000,000</td>
<td>13,422,000</td>
<td>13,422,000</td>
</tr>
<tr>
<td>Total B and C</td>
<td>42,211,600</td>
<td>5,601,400</td>
<td>7,518,199</td>
<td>48,729,799</td>
</tr>
<tr>
<td>% B and C to Total</td>
<td>11.08%</td>
<td>7.50%</td>
<td>7.50%</td>
<td>10.32%</td>
</tr>
<tr>
<td>B. Retail Investors w/RoSS Account (Sub-registry)</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1. Target Investors</td>
<td>3,685,200</td>
<td>295,900</td>
<td>397,157</td>
<td>4,082,357</td>
</tr>
<tr>
<td>2. Non-OFW Individuals</td>
<td>17,898,600</td>
<td>4,602,000</td>
<td>6,176,804</td>
<td>24,075,404</td>
</tr>
<tr>
<td>3. Trusts</td>
<td>19,627,800</td>
<td>703,500</td>
<td>944,238</td>
<td>20,572,938</td>
</tr>
<tr>
<td>C. Investors Under Accredited Custodian</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
</tbody>
</table>

Thank you
## Summary of MrTB Sales by Tenor and Number of Investors

### USD

<table>
<thead>
<tr>
<th>Denomination</th>
<th>3-Year</th>
<th>5-Year</th>
<th>TOTAL</th>
</tr>
</thead>
<tbody>
<tr>
<td>100 - 100,000</td>
<td>Number</td>
<td>Amount</td>
<td>Number</td>
</tr>
<tr>
<td>447</td>
<td>5,986,900</td>
<td>462</td>
<td>8,361,600</td>
</tr>
<tr>
<td>27</td>
<td>156,186,100</td>
<td>17</td>
<td>27,816,800</td>
</tr>
</tbody>
</table>

*not inclusive of PNB sales

### EUR

<table>
<thead>
<tr>
<th>Denomination</th>
<th>3-Year</th>
<th>5-Year</th>
<th>TOTAL</th>
</tr>
</thead>
<tbody>
<tr>
<td>100 - 50,000</td>
<td>Number</td>
<td>Amount</td>
<td>Number</td>
</tr>
<tr>
<td>34</td>
<td>459,700</td>
<td>29</td>
<td>501,100</td>
</tr>
<tr>
<td>3</td>
<td>183,100</td>
<td>7</td>
<td>581,000</td>
</tr>
<tr>
<td>1 - 100,000</td>
<td>Number</td>
<td>Amount</td>
<td>Number</td>
</tr>
<tr>
<td>52</td>
<td>720,200</td>
<td>43</td>
<td>1,147,800</td>
</tr>
<tr>
<td>10</td>
<td>44,924,400</td>
<td>7</td>
<td>3,852,200</td>
</tr>
</tbody>
</table>

*not inclusive of PNB sales
TOKYO PRO-BOND Market

~ A New International Wholesale Corporate Bond Market ~

December 13, 2010

Yutaka Ito

Chief Operating Officer, TOKYO AIM, Inc.
Relatively Large in terms of Market Size, but

Domestic and Retail Oriented Regulatory System

- Japanese language documentation is required.
- Highly regulated by the government authority, J-FSA.
- Emphasis on “small retail investor protection”.
- Tax burden for non-Japanese investors.
Expensive to enter for non-Japanese issuers.

Heavy legal responsibility for the underwriters.

Long and cumbersome issuing procedure for the issuers and underwriters.

Small issuing window for the issuers.

No incentives for non-Japanese investors to join.
1. Professional securities market system in the FIEA

- Introduction of the “stock exchange regulated” system.
- Targeting only professional investors - exclude retail.
- Allow English documentation.
2. **Tax exemption for non-Japanese investors**

- Japanese government introduced a tax exemption system in June 2010 for non-Japanese investors holding corporate bonds issued in Japan.

- The new system levies zero tax on non-Japanese investors. The old system used to levy 15% on interest earnings of non-Japanese investors.

※*Government and municipal bonds are already tax-exempted for non-Japanese investors.*
Utilizing these two pieces of legislation, Tokyo Stock Exchange Group is creating a new international wholesale corporate bond market.

- English-only documentation is accepted.
  - Significantly decrease the issuing cost for non-Japanese issuers.

- Wholesale market only for professional investors
  - Free from the obligation of “retail investor protection”.
Significantly decrease the legal responsibility for underwriters.
→ Wider issuing window and speedy issuance.

“Euro MTN type” issuing system.
- Program listing and draw-downs for individual issuances.
  - Stand-alone issuance is also accepted.

Accept multi currencies.
  - Not limited to JPY.

Include Municipal and Government Agency bonds.
Not limited to the JASDEC settlement system.

Trading is mainly on the OTC market.

New tax exemption system is applicable.

“TOKYO PRO-BOND Market” will be operated by TOKYO AIM, Inc., which is a JV between TSE Group (51%) and London Stock Exchange (49%).

TOKYO AIM is the only stock exchange for professionals in Japan.
<table>
<thead>
<tr>
<th></th>
<th>Current Market</th>
<th>TOKYO PRO-BOND Market</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Investors</strong></td>
<td>All, Including retail</td>
<td>Professionals only</td>
</tr>
<tr>
<td><strong>Regulated by</strong></td>
<td>J-FSA</td>
<td>Stock Exchange (TOKYO AIM, Inc.)</td>
</tr>
<tr>
<td><strong>Language</strong></td>
<td>Japanese</td>
<td>English and/or Japanese</td>
</tr>
<tr>
<td><strong>Legal responsibility for underwriters</strong></td>
<td>Heavy</td>
<td>Light</td>
</tr>
<tr>
<td><strong>Issuing window</strong></td>
<td>Narrow</td>
<td>Wide</td>
</tr>
<tr>
<td><strong>Currency</strong></td>
<td>JPY</td>
<td>JPY or Multi</td>
</tr>
<tr>
<td><strong>Settlement</strong></td>
<td>JASDEC</td>
<td>Not limited</td>
</tr>
</tbody>
</table>

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Implication for the ABMF discussion

Sequence of Bond Markets Development in Asia

How can we establish an Asian common set of standards and regulation to promote Cross-Border Inter-Regional (wholesale) Market in Asia?

- ABMF
- Asian SRO
- (Asian Supervisory Authorities)

Homogeneity

Eurobond Market
- Private Placement Market and Public Offering Market for professionals with common standard format
- Used to be a Self-Regulated Market by professional market players

Cross-Border Inter-Regional (wholesale) Bond Market in Asia
- Harmonization of heterogeneous rules and regulations for professionals in Asian region
- Facilitate inter-regional circulation of savings within Asia
- Creation of self-regulated Asian Inter-Regional (wholesale) Bond Market for professional market participants
- For instance, Asian Exchange regulated market

Heterogeneity

Local Bond Markets (Domestic Bond Market)
- Foster government bond market
- Create the benchmark yield curve
- Foster corporate bond markets
- Circulate domestic savings

Japan – Samurai Bond
Korea – Ariran Bond
China – Panda bond

Cross-Border Bond Markets (Foreign Bond Markets)
A Part of Domestic Market
- Outward issuance by residents, inward issuance by non-residents and cross-border investments
- Subject to home country or host country rules and regulations
- Different stage of economic development and heterogeneity in legal and institutional systems and infrastructure

Domestic

Current Japanese Market
- Tax exemption
- New market legislation

Inter-Regional

TOKYO PRO-BOND Market

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Nov 10, 2010
Announcement of the market framework.
Commencement of the public consultation.

Dec 9, 2010
End of the public consultation.

Jan – Feb, 2011
Announcement of the detailed rules.

Mar – Apr, 2011
Launch of the market.
i.e. First program listing or issuance.
Attached documents

- TOKYO AIM Press Release on Nov 10, 2010
- Market Framework of the TOKYO PRO-BOND Market

Please contact for details to

TOKYO AIM, Inc. (www.tokyo-aim.com)

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ASEAN+3 Bond Market Forum

Lee K. Kwan
Deputy CEO & Treasurer, CIMB Group
President of Financial Markets Association of Malaysia

13 December 2010
The ABMI Sub Forum 1’s data collection is expected to complete end-2011.

Should start focusing on what we hope to achieve with the information gathered.

Presumably, the data collection exercise is part and parcel of the means to an end where the overriding objective is to facilitate the mobilization of ASEAN+3 savings cross border into the ASEAN+3 region as they are currently disproportionately invested in USD and EUR denominated assets.

While the data collection exercise continues as per the scheduled timeline, I would like to propose and put it to the task force assembled here whether a separate and concurrent stream should be set up to address the objectives of mobilizing ASEAN+3 savings into the ASEAN+3 region.
Recap 1 of ASEAN+3 Objectives

Non-Domestic Investments

- Excess ASEAN+3 Savings
  - Deposits > (Loans + Bonds)
  - Savings >= 30% of GDP

Private Sector Investments:
- ASEAN+3 Central Banks FX Reserves
- Banks, Mutual Funds, Pension Funds, Individual, etc.

Public Sector Investments:
- ASEAN+3 Central Banks FX Reserves
- Western Markets
  - US / European Govt Bonds
  - Bail out Western Banking Groups - US & European, Subprime Mortgages, etc.

To compete in ASEAN+3 Markets

- Invest in ASEAN+3
  - High Growth Economies
  - Charging Expensive Credit Spreads

0% to 5%
95% to 100%
[US Treasury + 0%]

- ASEAN+3 Local Currency Market
  - Sovereign & Corporates

- ASEAN+3

Non-domestic investments of each ASEAN+3 nations excess savings (public & private sector) are predominantly lent to the US/European markets at the lowest possible yields (Treasuries flat) and reinvested back into High Growth ASEAN+3 economies at much higher credit spreads or to bail out their banks so that they can continue to compete in ASEAN+3.

Non-domestic investments of each ASEAN+3 nation of its excess savings are seldom ever invested in the ASEAN+3 region outside its domestic border, relying on Western institutions to do so, funded mostly by ASEAN+3 savings.
Recap 2 of ASEAN+3 Objectives

- To significantly increase the direct non-domestic investment of ASEAN+3 excess savings (public and private investments) into the ASEAN+3 local currency markets (sovereign and corporates) as opposed into USD/EUR markets.

- To promote local currency sovereign and corporate bond markets to same degree as what ASEAN+3 governments do for their (local currency) equity markets.
Recap 3 of ASEAN+3 Objectives

1. Currently the effort is very focused on cross border issuance, including for the data collection exercise

2. It is equally as important, if not more important, to focus on enabling ASEAN+3 cross-border investment flows (into ASEAN+3 regional local currency markets)

3. If there is no (ASEAN+3 cross border investment) demand, this entire exercise is doomed to failure regardless of how strong the ASEAN+3 cross border issuance pipeline

4. And, the focus should not be about Western or Global investors

5. The focus should be centered on ASEAN+3 excess savings and the ASEAN+3 investor base; to better enable the redeployment of ASEAN+3 savings from the USD/EUD markets into the ASEAN+3 domestic currency markets
Proposal to start up Stream 2 under Task Force 1 focusing on:

a. Enabling ASEAN+3 Cross Border Investments (in local currency)
b. Enabling ASEAN+3 Cross Border Issuance (in issuer’s local currency)
c. ABF2/ABF3
Enabling ASEAN+3 Cross Border Investments (in local currency)

(A) Establishment of a New International Credit Rating Agency to be owned by ASEAN+3 private and perhaps public sector stake holders ("New International Credit Rating Agency")

- The New International Credit Rating Agency ("NICRA") needs to first focus on global coverage of Sovereign ratings encompassing major countries in North America, Europe, Latin America and ASEAN+3 nations.

- Global Sovereign ratings are critical because:
  a. international credit ratings are a major component of the global capital allocation system for savings and investments determining amount to be allocated by country across the globe. It is only thereafter that the sub-allocation to the sovereign’s corporates and banks come in
  b. Also, ratings of corporates and banks are mostly capped by their own Sovereign’s rating
  c. as such, for the NRIC, a global Sovereign rating approach covering every major nation (not just ASEAN+3) is critical to determine the capital allocation across nations and then within it the rating of each corporate and bank in that nation

- The credit rating methodology of NICRA must focus on the probability of default of the nation as the sole sovereign rating criteria, utilizing objective empirical data and to significantly de-emphasize subjective factors to determine sovereign ratings.

* "The New International Credit Rating Agency will not encroach into local rating businesses of domestic credit rating agencies in the region.”
### Country and Financial Indicators

<table>
<thead>
<tr>
<th></th>
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<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>3Q2010</td>
<td>3Q2010</td>
<td>3Q2010</td>
<td>3Q2010</td>
<td>2009</td>
<td>2009</td>
</tr>
<tr>
<td>China</td>
<td>2,648</td>
<td>3.8</td>
<td>69,684%</td>
<td>2,377</td>
<td>54.0%</td>
<td>2,762.8</td>
</tr>
<tr>
<td>Malaysia</td>
<td>97</td>
<td>4.0</td>
<td>2,425%</td>
<td>242</td>
<td>34.4%</td>
<td>92.1</td>
</tr>
<tr>
<td>Indonesia</td>
<td>86</td>
<td>35.0</td>
<td>245%</td>
<td>100</td>
<td>27.0%</td>
<td>146.9</td>
</tr>
<tr>
<td>Thailand</td>
<td>157</td>
<td>0.7</td>
<td>22,429%</td>
<td>176</td>
<td>30.0%</td>
<td>89.2</td>
</tr>
<tr>
<td>Korea</td>
<td>290</td>
<td>7.8</td>
<td>3,718%</td>
<td>498</td>
<td>30.1%</td>
<td>281.1</td>
</tr>
<tr>
<td>Italy</td>
<td>36</td>
<td>2102</td>
<td>1.7%</td>
<td>1,443</td>
<td>19.0%</td>
<td>382.3</td>
</tr>
<tr>
<td>Portugal</td>
<td>2.3</td>
<td>178</td>
<td>1.3%</td>
<td>140</td>
<td>13.0%</td>
<td>28.8</td>
</tr>
<tr>
<td>Spain</td>
<td>13</td>
<td>729</td>
<td>1.8%</td>
<td>573</td>
<td>22.0%</td>
<td>306.8</td>
</tr>
<tr>
<td>Ireland</td>
<td>0.5</td>
<td>131</td>
<td>0.4%</td>
<td>119</td>
<td>23.0%</td>
<td>48.6</td>
</tr>
<tr>
<td>U.S.</td>
<td>Infinite (Own Local Currency)</td>
<td>NA</td>
<td>-</td>
<td>10,025</td>
<td>10.9%</td>
<td>1,533.8</td>
</tr>
</tbody>
</table>

(A) Establishment of a New International Credit Rating Agency to be owned by ASEAN+3 stakeholders (“NICRA”)

The empirical factors to assess probability of default and credit rating of the sovereign should focus on:

1) **Current & Forward looking Balance Sheet strength of the Sovereign including:**
   - Foreign currency reserves vs foreign currency debt
   - Local currency debt vs savings rate and liquidity in the domestic banking system
   - Current and future deficits, revenue and expenditure streams
   - Ability to print own currency (to conduct quantitative easing)

   •**Cannot print enough local currency government debt to satisfy domestic demand**
   •**This is unique to countries with very high savings rate, in particular ASEAN+3 countries**
   •**Roll over risks of local currency debt is low**
   •And with zero dependency on foreign currency funding coupled with high FX reserves, where is the default risk going to come from when collateral cover is high?
(A) Establishment of a New International Credit Rating Agency to be owned by ASEAN+3 stakeholders (“NICRA”)

The empirical measures that dominate to assess credit rating and probability of default should focus on:

1) Forward looking balance sheet health of Sovereign
   • Foreign currency reserves vs foreign currency debt
   • Local currency debt vs savings rate and liquidity in the domestic local currency banking system
   • Ability to print own currency (to conduct quantitative easing)

2) Current & Forward looking income statement of Sovereign
   • Trade deficit / surpluses
   • Capital account deficits / surpluses
   • Openness of capital account
   • Forward looking fiscal deficit / surpluses
(A) Establishment of a New International Credit Rating Agency to be owned by ASEAN+3 stakeholders (“NICRA”)

<table>
<thead>
<tr>
<th>Country</th>
<th>Current Account (% of GDP)*</th>
<th>Trade Balance (% of GDP)*</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>2009</td>
<td>2009</td>
</tr>
<tr>
<td>China</td>
<td>6%</td>
<td>4%</td>
</tr>
<tr>
<td>Malaysia</td>
<td>16%</td>
<td>17%</td>
</tr>
<tr>
<td>Indonesia</td>
<td>2%</td>
<td>4%</td>
</tr>
<tr>
<td>Thailand</td>
<td>8%</td>
<td>7%</td>
</tr>
<tr>
<td>Korea</td>
<td>4%</td>
<td>5%</td>
</tr>
<tr>
<td>Italy</td>
<td>-3%</td>
<td>-0.3%</td>
</tr>
<tr>
<td>Portugal</td>
<td>-10%</td>
<td>-1.0%</td>
</tr>
<tr>
<td>Spain</td>
<td>-5%</td>
<td>-0.4%</td>
</tr>
<tr>
<td>Ireland</td>
<td>-3%</td>
<td>1.9%</td>
</tr>
<tr>
<td>U.S.</td>
<td>-0.7%</td>
<td>-0.3%</td>
</tr>
</tbody>
</table>

Current & trade surpluses not ending anytime soon

Income Statement Strength
The empirical measures that dominate to assess credit rating and probability of default should focus on:

1) Forward looking balance sheet health of Sovereign

2) Forward looking income statement of Sovereign

3) Subjective considerations such as “financial stability” (whatever that means especially for the Eurozone) as well as political considerations such as democracy, right to assemble and protest, etc should be significantly deemphasized

4) These factors have nothing to do with the Sovereign’s ability to honor its debt and its probability of default.

Currently, the subjective considerations can at times so overwhelm the sovereign rating process versus credit risk fundamentals in balance sheet and income statement strengths that the resulting ratings can be bewildering and are disconnected from market prices in both CDS’es and cash bond spreads

On the next slide, the five Asean+3 nations listed should have sovereign ratings higher than AA1/Aa as all these five Asean+3 nations have stronger credit fundamentals vs Spain and Ireland and which sovereign market prices in CDS’es and bond spreads will testify
Example of the Dire Need for a New International Credit Rating Agency

<table>
<thead>
<tr>
<th>Country</th>
<th>5-year CDS</th>
<th>Moody’s/ S&amp;P Rating</th>
<th>Moody’s/ S&amp;P Rating</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>End Nov 2010</td>
<td>End Sep 2010</td>
<td>End Nov 2010</td>
</tr>
<tr>
<td>Italy</td>
<td>268</td>
<td>Aa2/A+</td>
<td>Aa2/A+</td>
</tr>
<tr>
<td>Portugal</td>
<td>543</td>
<td>A1/A-</td>
<td>A1/A-</td>
</tr>
<tr>
<td>Spain</td>
<td>364</td>
<td>Aa1/AA</td>
<td>Aa1/AA</td>
</tr>
<tr>
<td>Ireland</td>
<td>605</td>
<td>Aa2/AA-</td>
<td>Aa2/A*</td>
</tr>
<tr>
<td>U.S.</td>
<td>44</td>
<td>Aaa/AAA</td>
<td>Aaa/AAA</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Deutsche AG</td>
<td>118</td>
<td>Aa3/A+</td>
<td>Aa3/A+</td>
</tr>
<tr>
<td>Barclays</td>
<td>129</td>
<td>A1/A+</td>
<td>A1 / A+</td>
</tr>
<tr>
<td>RBS</td>
<td>397</td>
<td>A1/A</td>
<td>A1 / A</td>
</tr>
<tr>
<td>Santander</td>
<td>441</td>
<td>Aa2/AA</td>
<td>Aa2/AA</td>
</tr>
<tr>
<td>China</td>
<td>76</td>
<td>A1/A+</td>
<td>Aa3/A+*</td>
</tr>
<tr>
<td>Malaysia</td>
<td>91</td>
<td>A3/A-</td>
<td>A3/A-</td>
</tr>
<tr>
<td>Indonesia</td>
<td>154</td>
<td>Ba2/BB</td>
<td>Ba2/BB</td>
</tr>
<tr>
<td>Thailand</td>
<td>114</td>
<td>Baa1/BBB+</td>
<td>Baa1/BBB+</td>
</tr>
<tr>
<td>Korea</td>
<td>121</td>
<td>A1/A</td>
<td>A1/A</td>
</tr>
</tbody>
</table>

- Implications of relying on existing international Sovereign ratings for ASEAN+3 savings:
  - Based on the above, ASEAN+3 banks and ASEAN+3 fund managers should stop buying their own government’s debt or lend to ASEAN+3 corporates or place interbank deposits with ASEAN+3 banks and stop clearing with their own central banks based on global credit ratings.
  - ASEAN+3 banks should instead dedicate their balance sheets to buying much higher rated US & European government bonds, lending to US & European governments and corporates and placing inter-bank deposits with European and American banks (with the additional benefit of yields/credit spreads).
  - Furthermore, this will immediately increase ASEAN+3 banks Basel 2 capital ratios (Core Tier 1, Tier 1 and RWCR capital ratios).
Example of the Dire Need for a More Neutral Credit Rating Agency

• In the past, the impact of international ratings only affected cross border investments of ASEAN+3 central banks (fx reserves), domestic banks’ cross border assets (foreign currency loans and bonds) and cross border investments of their mutual and pension funds.

• With the onset of Basel 2 being implemented in ASEAN+3, it will now capture the entire asset base of ASEAN+3 banks including loans, bonds and derivatives as every loan, bonds and derivative need to be internally credit rated, which is impaired by their sovereign rating.

• The existing Sovereign ratings are akin to an extremely powerful vacuum suction of ASEAN+3 savings to the higher credit rated Western economies already currently amounting to USD trillions.

• **Practical Reality:** Investment committees of ASEAN+3 central banks (in managing their FX reserves), the investment committees of mutual and pension funds (in managing their portfolios) and the credit committees of ASEAN+3 banks will require ratings to guide their investments and lending decisions.

• Currently, the sole reliance is on Western international credit ratings with all their vested interests as the credit rating infrastructure in Asean+3 is limited to domestic rating agencies.

• **The need for a New International Credit Rating Agency owned by ASEAN+3 stakeholders is never more urgent.**
(B) In the interim while the establishment of the New International Credit Rating Agency is being deliberated, it is proposed that we proceed with the mutual recognition of existing ASEAN+3 local credit rating agencies.

However, to qualify for mutual recognition, the ASEAN+3 local credit rating agencies must meet clear empirical minimum standards perhaps including the following:

- **minimum 10-year track record of credit rating history** (as most bonds issued to-date are of 5-year tenor, there is then reasonable default and credit rating migration history to evaluate the stability and accuracy of initial ratings and actual default history over a reasonable time period)
- **minimum number of solicited local currency rated issues**: >= 100 ratings to date
- **must be regulated by their domestic regulator**
- **minimum capital requirement to ensure “going concern”**
- **shareholding structure should be reasonably diverse to promote independence**
### Enabling ASEAN+3 Cross Border Investments (in local currency) … cont

<table>
<thead>
<tr>
<th>Country</th>
<th>Rating Agency</th>
<th>Established</th>
<th>Shareholders</th>
<th>Shareholder’s Funds</th>
<th>No. of rated issues</th>
<th>7-year migration data</th>
</tr>
</thead>
<tbody>
<tr>
<td>Japan</td>
<td>JCRA</td>
<td>1985</td>
<td>Major life and casualty insurance companies, all trust banks, 60 of 64 regional banks</td>
<td>JPY 584 million (USD 7 million) – paid up cap</td>
<td>-</td>
<td>Yes</td>
</tr>
<tr>
<td>Korea</td>
<td>KIS</td>
<td>1985</td>
<td>Moody’s Investors Service and Nice Information Service</td>
<td>-</td>
<td>339 rated issues</td>
<td>-</td>
</tr>
<tr>
<td>Thailand</td>
<td>TRIS</td>
<td>1993</td>
<td>Govt savings bank, MOF, Commercial banks, Stock Exchange of Thailand, Finance &amp; Securities companies, Mutual funds, Insurance companies and Asian Development Bank</td>
<td>THB50 million (USD 1.6 million)</td>
<td>88 rated issues</td>
<td>Yes</td>
</tr>
<tr>
<td>Indonesia</td>
<td>PEFINDO</td>
<td>1993</td>
<td>Major pension funds, banks, and insurers</td>
<td>-</td>
<td>250 rated issues</td>
<td>Yes</td>
</tr>
<tr>
<td>Philippines</td>
<td>PHILRATINGS</td>
<td>1985</td>
<td>It is 70%-owned by Motan Corporation and 30%-owned by CIBI Foundation, Inc.</td>
<td>-</td>
<td>368 rated issues</td>
<td>-</td>
</tr>
<tr>
<td>China</td>
<td>DAGONG</td>
<td>1994</td>
<td>Privately owned</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>China</td>
<td>Xinhua Finance</td>
<td>1999</td>
<td>Luck Wing Group Ltd, NIS Group Co Ltd, Patriarch Partners &amp; Affiliates, Fredy Bush Family Trust and Associated Co</td>
<td>USD25 million</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Malaysia</td>
<td>RAM</td>
<td>1990</td>
<td>Major life/general insurers, stockbrokers, and investment banks</td>
<td>RM86 million (USD27 million)</td>
<td>499 rated issues</td>
<td>Yes</td>
</tr>
<tr>
<td>Malaysia</td>
<td>MARC</td>
<td>1995</td>
<td>Major life/general insurers, stockbrokers, and investment banks</td>
<td>RM42 million (USD13 million)</td>
<td>470 rated issues</td>
<td>Yes</td>
</tr>
</tbody>
</table>
Strong Performance of Local Rating Agencies Straddling Two Major Credit Cycles

### Thailand (1994 – 2009) - TRIS

<table>
<thead>
<tr>
<th>Rating (From/To) (%)</th>
<th>AAA</th>
<th>AA</th>
<th>A</th>
<th>BBB</th>
<th>BB</th>
<th>B</th>
<th>C</th>
<th>D</th>
</tr>
</thead>
<tbody>
<tr>
<td>AAA</td>
<td>75.00</td>
<td>25.00</td>
<td>0.00</td>
<td>0.00</td>
<td>0.00</td>
<td>0.00</td>
<td>0.00</td>
<td>0.00</td>
</tr>
<tr>
<td>AA</td>
<td>1.56</td>
<td>89.06</td>
<td>7.82</td>
<td>0.00</td>
<td>0.00</td>
<td>0.00</td>
<td>0.00</td>
<td>1.56</td>
</tr>
<tr>
<td>A</td>
<td>0.00</td>
<td>3.56</td>
<td>92.89</td>
<td>3.11</td>
<td>0.00</td>
<td>0.00</td>
<td>0.00</td>
<td>0.44</td>
</tr>
<tr>
<td>BBB</td>
<td>0.00</td>
<td>0.00</td>
<td>6.41</td>
<td>86.75</td>
<td>2.56</td>
<td>0.86</td>
<td>0.00</td>
<td>3.42</td>
</tr>
</tbody>
</table>

### Indonesia (1996 – 2009) - Pefindo

<table>
<thead>
<tr>
<th>Rating (From/To) (%)</th>
<th>AAA</th>
<th>AA</th>
<th>A</th>
<th>BBB</th>
<th>BB</th>
<th>B</th>
<th>CCC</th>
<th>D</th>
<th>NR</th>
</tr>
</thead>
<tbody>
<tr>
<td>AAA</td>
<td>73.33</td>
<td>0.00</td>
<td>0.00</td>
<td>0.00</td>
<td>0.00</td>
<td>0.00</td>
<td>0.00</td>
<td>0.00</td>
<td>26.67</td>
</tr>
<tr>
<td>AA</td>
<td>4.49</td>
<td>77.53</td>
<td>5.62</td>
<td>0.00</td>
<td>1.12</td>
<td>0.00</td>
<td>0.00</td>
<td>1.12</td>
<td>10.11</td>
</tr>
<tr>
<td>A</td>
<td>0.28</td>
<td>6.41</td>
<td>73.26</td>
<td>1.95</td>
<td>0.56</td>
<td>0.00</td>
<td>0.00</td>
<td>2.51</td>
<td>15.04</td>
</tr>
<tr>
<td>BBB</td>
<td>0.00</td>
<td>0.54</td>
<td>8.13</td>
<td>48.78</td>
<td>3.52</td>
<td>0.81</td>
<td>1.63</td>
<td>6.50</td>
<td>30.08</td>
</tr>
</tbody>
</table>

### Malaysia (1992 – 2009) - RAM

<table>
<thead>
<tr>
<th>Rating (From/To) (%)</th>
<th>AAA</th>
<th>AA</th>
<th>A</th>
<th>BBB</th>
<th>BB</th>
<th>B</th>
<th>CCC</th>
<th>D</th>
</tr>
</thead>
<tbody>
<tr>
<td>AAA</td>
<td>98.39</td>
<td>1.61</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0.00</td>
</tr>
<tr>
<td>AA</td>
<td>1.62</td>
<td>94.65</td>
<td>2.43</td>
<td>0.97</td>
<td>0.16</td>
<td>0</td>
<td>0.16</td>
<td>0</td>
</tr>
<tr>
<td>A</td>
<td>0.13</td>
<td>4.05</td>
<td>87.99</td>
<td>6.45</td>
<td>0.25</td>
<td>0.25</td>
<td>0</td>
<td>0.88</td>
</tr>
<tr>
<td>BBB</td>
<td>0.2</td>
<td>0.61</td>
<td>5.73</td>
<td>79.96</td>
<td>9.82</td>
<td>1.23</td>
<td>1.02</td>
<td>1.43</td>
</tr>
<tr>
<td>BB</td>
<td>0</td>
<td>0</td>
<td>0.51</td>
<td>7.69</td>
<td>70.26</td>
<td>7.69</td>
<td>3.59</td>
<td>10.26</td>
</tr>
<tr>
<td>B</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>6.25</td>
<td>84.38</td>
<td>5.21</td>
<td>4.17</td>
</tr>
<tr>
<td>C</td>
<td>0</td>
<td>0</td>
<td>3.45</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>58.62</td>
<td>37.93</td>
</tr>
</tbody>
</table>

In Thailand, Malaysia and Indonesia:

- there are ZERO defaults for AAA rated bonds over the last 15 years encompassing the 2008 and 1997/98 credit cycles
- Defaults rates for AA and A rated bonds are low
- This is based on a 15 year time series straddling across two major credit cycles
- ASEAN+3 domestic credit rating agencies potentially have superior default ratios versus international rating agencies for the same rating (AAA, AA, A etc)
Enabling ASEAN+3 Cross Border Investments (in local currency)….cont

S&P 2009 Corporate Transition Rates for Global Markets

<table>
<thead>
<tr>
<th>From/to</th>
<th>AAA</th>
<th>AA</th>
<th>A</th>
<th>BBB</th>
<th>BB</th>
<th>B</th>
<th>CCC/C</th>
<th>D</th>
<th>NR</th>
</tr>
</thead>
<tbody>
<tr>
<td>AAA</td>
<td>87.65</td>
<td>8.64</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>3.7</td>
<td></td>
</tr>
<tr>
<td>AA</td>
<td>0</td>
<td>76.17</td>
<td>15.96</td>
<td>0.64</td>
<td>0.21</td>
<td>0</td>
<td>0</td>
<td>7.02</td>
<td></td>
</tr>
<tr>
<td>A</td>
<td>0</td>
<td>0.36</td>
<td>84.67</td>
<td>7.74</td>
<td>0.43</td>
<td>0.29</td>
<td>0</td>
<td>0.21</td>
<td>6.3</td>
</tr>
<tr>
<td>BBB</td>
<td>0</td>
<td>0</td>
<td>2</td>
<td>83.71</td>
<td>5.94</td>
<td>0.8</td>
<td>0.2</td>
<td>0.53</td>
<td>6.81</td>
</tr>
<tr>
<td>BB</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>3.09</td>
<td>72.95</td>
<td>11.48</td>
<td>0.6</td>
<td>0.7</td>
<td>11.18</td>
</tr>
<tr>
<td>B</td>
<td>0</td>
<td>0</td>
<td>0.16</td>
<td>0</td>
<td>2.29</td>
<td>69.34</td>
<td>8.42</td>
<td>10.14</td>
<td>9.65</td>
</tr>
<tr>
<td>CCC/C</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>6.32</td>
<td>27.37</td>
<td>48.42</td>
<td>17.89</td>
</tr>
</tbody>
</table>

• The S&P corporate transition rates are comparable

• But once the structured finance universe is included (a USD3.285 trillion asset base and hence the major recession in the US), the AAA, AA and A rated universe of the Asean+3 domestic rating agencies have superior credit migration data and lower default ratios


<table>
<thead>
<tr>
<th>From/to</th>
<th>AAA</th>
<th>AA</th>
<th>A</th>
<th>BBB</th>
<th>BB</th>
<th>B</th>
<th>CCC</th>
<th>CC</th>
<th>C</th>
<th>D</th>
<th>NR</th>
</tr>
</thead>
<tbody>
<tr>
<td>AAA</td>
<td>15.15</td>
<td>2.47</td>
<td>2.12</td>
<td>2.95</td>
<td>4.18</td>
<td>7.98</td>
<td>35.52</td>
<td>9.30</td>
<td>0.00</td>
<td>10.71</td>
<td>9.25</td>
</tr>
<tr>
<td>AA+</td>
<td>17.05</td>
<td>2.47</td>
<td>2.77</td>
<td>3.11</td>
<td>6.66</td>
<td>30.62</td>
<td>16.87</td>
<td>0.00</td>
<td>18.99</td>
<td>1.47</td>
<td></td>
</tr>
<tr>
<td>AA</td>
<td>0.02</td>
<td>11.66</td>
<td>1.47</td>
<td>1.51</td>
<td>2.90</td>
<td>4.87</td>
<td>23.92</td>
<td>20.54</td>
<td>0.00</td>
<td>29.79</td>
<td>3.33</td>
</tr>
<tr>
<td>AA-</td>
<td>8.89</td>
<td>2.01</td>
<td>1.46</td>
<td>1.56</td>
<td>4.35</td>
<td>20.44</td>
<td>19.65</td>
<td>0.00</td>
<td>39.64</td>
<td>2.01</td>
<td></td>
</tr>
</tbody>
</table>
(C) Regulatory and mutual recognition

- **It is about mutual recognition (not harmonization) of the regulatory regime in each ASEAN+3 country, giving due respect to the standards run by each country’s regulators.**
- Ultimately, we need mutual regulatory recognition across multi-jurisdiction where Country A’s ratings are acknowledged and accepted in Country B with the same regulatory treatment of how Country B recognizes the credit ratings of its own domestic credit rating agencies.
- This would then enable ASEAN+3 private sector banks, mutual funds/unit trusts, pension funds and ASEAN+3 central banks (FX reserves) to invest cross border in ASEAN+3 local currency government and corporate bond markets.
- **Regulators should also accord some degree of recognition to the private sector that they are able to make reasonable risk return decisions on their cross border investments.**
Enabling ASEAN+3 Cross Border Investments (in local currency)….cont

(D) Need to differentiate between Domestic Investors versus ASEAN+3 Investors versus Non ASEAN+3 investors.

- ASEAN+3 funds are not hot money as they are mostly long only funds reflecting the very nature of the high savings rate of each ASEAN+3 nation. With global funds, the vast majority are leveraged funds (funded by debt) and pure long only funds are the small minority.
- ASEAN+3 needs to create a separate investor class for ASEAN+3 investors (but definition is critical to isolate out “hot money”)
- Preferably ASEAN+3 investors (definition is critical) should be accorded the same treatment as its domestic investors (in line with the guiding principles of AFTA on trade)

(E) Central Bank FX ECM rules on ASEAN+3 cross border investments to be standardized for ASEan+3 investors:

- allow free repatriation of proceeds including coupons and principal
- allow FX and interest rate portfolio hedging of local currency government and corporate bond and equity holdings and free repatriation of hedging gains and losses
Enabling ASEAN+3 Cross Border Investments (in local currency)….cont

(F) **Liberalize withholding taxes for Asean+3 cross border local currency investments**

- At the minimum, the withholding taxes for Asean+3 cross border investors should be no worse than USD Reg S issuances by Asean+3 sovereigns, banks and corporates
- The ideal is withholding taxes for ASEAN+3 investors should be no different to what is being charged for domestic investors

(G) **To facilitate direct Asean+3 FX crosses to settle intra ASEAN+3 investments and real trade flows of imports and exports**

- Each ASEAN+3 central bank to set up nostro accounts for each member ASEAN+3 nation in their respective local currencies
- This will enable ASEAN+3 nations and banks to conduct direct FX crosses to settle their intra region investment and real trade flows (imports and exports)
- Currently, all intra ASEAN+3 real trade (import and export) and investment flows have to cross through USD (some cases EUD) even for pure intra regional Asean+3 trade and investment flows
Enabling ASEAN+3 Cross Border Investments (in local currency)….cont

End objectives to be achieved on ASEAN+3 cross border investments:

• Enable ASEAN+3 cross border investments across the Asean+3’s Sovereign and Corporate Local Currency Bond and Loan markets for ASEAN+3 central banks (FX reserves), ASEAN+3 mutual and pension funds and ASEAN+3 banks.

• The biggest impediment today is the reliance on international credit rating agencies to determine Asean+3 investment decisions on its vast pool of savings

• **Asean+3 needs to take out all the bottlenecks that inhibit Asean+3 cross border investments. This will be the main determinant of success or failure**

• Create a separate investors class for ASEAN+3 investors (definition is critical to isolate out “hot money” as otherwise it will jeopardize the whole ASEAN+3 investor class)

• Asean+3 investors definition should include ASEAN+3 public or private sector ownership, with funds sourced from ASEAN+3 sources, zero leverage and ASEAN+3 owned banks
Proposal to start up Stream 2 under Task Force 1 focusing on:

a. Enabling ASEAN+3 Cross Border Investment (in local currency)
b. Enabling ASEAN+3 Cross Border Issuance (in issuer’s local currency)
c. ABF2/ABF3
Enabling ASEAN+3 Cross Border Issuance (in issuer’s local currency)

- Currently, ASEAN+3 issuers either tap local currency bond markets or Eurobond Reg S/144a markets.

- Completely bypasses Asean+3 cross border domestic institutional investors. The outflow of supply in turn reduces the size and liquidity, and therefore the attractiveness of ASEAN+3 local currency bond markets. ASEAN+3 investors instead have to invest in Eurobonds for Asean+3 credits cross border.

- The end objective should be to expand the markets for local currency bonds from just home country investor base to ASEAN+3 wide investor base. This will also enable Asean+3 investors to be more familiar with cross border Asean+3 sovereigns and corporates – reality today is that global fund managers are more familiar with the investment thesis of (cross border) Asean+3 sovereigns and corporates than most Asean+3 fund managers and banks.
Enabling ASEAN+3 Cross Border Issuance (in issuer’s local currency)

- Mutual Recognition of Regulations - approval in home country (Country A) should be good enough for host country (Country B). No additional approvals should be required for ASEAN+3 issuers.

- Critical to put the process for Asean+3 issuances on par with Eurobond Reg S issuances by Asean+3 sovereign and corporates

- Regulatory arbitrage is already the reality for Eurobond Reg S issue. This cannot be reversed and Reg S needs to be the minimum standard to make it on par for Asean+3 local currency sovereign and corporate issuances

- Mutual recognition of information memorandum alone is not sufficient

- Need to differentiate ASEAN+3 issuers from non Asean+3 issuers, similar to AFTA for trade flows
# Enabling ASEAN+3 Cross Border Issuance (in issuer’s local currency)

<table>
<thead>
<tr>
<th>Selling Restriction</th>
<th>ASEAN+3 Local Currency Bonds</th>
<th>Eurobonds/Reg S Issues</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cannot sell cross border</td>
<td>Can sell to all markets including ASEAN+3 countries</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Cost</th>
<th></th>
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</thead>
<tbody>
<tr>
<td>1 Book Runner + 4 sets of lawyers for each local currency. A 3-currency MTN program will need 3 Bookrunners + 6 to 12 sets of lawyers</td>
<td>1 Book runner + 4 set of lawyers</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Approvals</th>
<th></th>
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</tr>
</thead>
<tbody>
<tr>
<td>1 approval for each country where target investors domicile or for each MTN program.</td>
<td>No approval required most of the time.</td>
<td></td>
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</table>

<table>
<thead>
<tr>
<th>Rating</th>
<th></th>
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</tr>
</thead>
<tbody>
<tr>
<td>1 rating for each country where target investors domicile or for each MTN program.</td>
<td>Normally 1 international rating is sufficient.</td>
<td></td>
</tr>
</tbody>
</table>

One blanket regulatory approval is sought, then the offering can be sold down in the rest of the ASEAN+3 countries. Currently, this is already allowed for Reg S issuances but these are only in Dollar denominated offerings of Asean+3 sovereigns and corporates.
Proposal to start up Stream 2 under Task Force 1 focusing on:

a. Enabling ASEAN+3 Cross Border Investment (in local currency)
b. Enabling ASEAN+3 Cross Border Issuance (in issuer’s local currency)
c. ABF2/ABF3
Capitalizing on ABF2 or Setting up of ABF3 to Identify All the Impediments to Cross Border Asean+3 Investing and Issuances

2003 – ABF1
- Size USD1 billion
- USD Bonds
- Sovereign
- Managed by BIS

2005 – ABF2
- Size USD2 billion
- Local Currency
- Sovereign
- Selected Quasi Sovereign
- Managed by International Fund Manager & Selected Local Fund Managers
- Resulted in removals of impediments such as exchange controls & taxes

2011: Proposed ABF3 / Extension of ABF2
- Size USD2 billion
- Focusing on Asean+3 Cross Border Local Currency:
  a) Primary Issuances of sovereign & corporates
  b) Secondary markets of Sovereign & Corporate Bonds
  c) Set up as Private Sector Fund with no preferential treatment and abiding with all existing cross border regulations
  d) Portfolio hedging of interest rate and currency risks
  e) Repatriation of coupon, principal, capital gains/losses, hedging gains and losses, withholding tax, settlement and custodian issues

- To set up ABF3 or sell down existing ABF2 holdings (at significant capital gains)

- Objectives are to identify impediments in cross investing in Asean+3 local currency sovereign and corporate bonds in both primary issuances and secondary markets

- However, ABF2/3 must be set up as a pure private sector fund, with no special privileges and complying with all regulations, as otherwise it defeats the purpose

- Most important portfolio management question to address is what is the portfolio investment criteria and minimum credit rating? If it is based on international CRAs where single A rating or better is the usual requirement, bulk of the Asean+3 sovereign and corporates will not qualify

- Utilising Mutual Recognition for ASEAN+3 domestic CRAs pending the establishment of Pan ASEAN+3 Owned CRA
Summary: ASEAN+3 Regional Bond Markets End State

1. ASEAN+3 investors (central banks FX reserves, pension and mutual funds, banks) enabled to invest cross border in regional local currency sovereign and corporate issuances and secondary markets similar to what they can readily invest in cross border for ASEAN+3 Reg S Dollar denominated issuances

2. ASEAN+3 sovereigns and corporates enabled to issue cross border in their own local currencies as easily as they can in Reg S Dollar denominated bonds

3. Benchmark to achieve is Reg S for ease of cross border issuances and investments but in regional local currencies
Proposed Timelines for Stream 2
Proposed Timeline for Stream 2

- Finalize proposal for Stream 2 in the next ABMF Sub Forum 1 Meeting in KL in February 2011
- To be tabled in the main Task Force meeting in March 2011
- To accomplish all the tasks in Stream 2 by end 2011 coinciding with the completion of the data gathering exercise
- End objective is to commence ASEAN+3 cross border investments and issuances beginning 2012
### Timeline for Stream 2

<table>
<thead>
<tr>
<th>Dec’10</th>
<th>Mar’11</th>
<th>Jun’11</th>
<th>Sep’11</th>
<th>Dec’11</th>
</tr>
</thead>
<tbody>
<tr>
<td>Info Memo &amp; Rating Rationale to be in English</td>
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<tr>
<td>Country A allows selling activity by Issuer from Country B</td>
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<tr>
<td>Pan Asean+3 Owned Rating Agency</td>
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<td></td>
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<tr>
<td>Mutual Recognition of National CRAs needed</td>
<td></td>
<td></td>
<td></td>
<td></td>
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<tr>
<td>Exchange Control rules in Country A to allow efficient settlement, custodianship &amp; hedging of interest rate &amp; currency risks</td>
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<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Exchange Control rules in Country B to allow investment in Asean+3 bond markets</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>No withholding tax for Asean+3 investors</td>
<td></td>
<td></td>
<td></td>
<td></td>
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<tr>
<td>No Capital Gain Tax for Asean+3 investors</td>
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<td></td>
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<tr>
<td>No restriction on repatriation of proceeds for Asean+3 investors</td>
<td></td>
<td></td>
<td></td>
<td></td>
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<tr>
<td>No approval for Asean+3 Issuers</td>
<td></td>
<td></td>
<td></td>
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<tr>
<td>ABF3</td>
<td></td>
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</table>
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Thank you
TOKYO AIM to Launch TOKYO PRO-BOND Market for Professionals

New market provides issuing flexibility similar to MTNs in the Euromarket
English language documentation will significantly reduce costs
Tax exemptions expected to attract foreign investors

TOKYO AIM, Inc. ("TOKYO AIM") today published an outline framework for its new bond market for professional investors, the TOKYO PRO-BOND Market.

The TOKYO PRO-BOND Market is designed to be as competitive as the Euromarket and over time become a central bond market for the Asian region. The new market will enable issuers to benefit from a speed and flexibility of issuance equivalent to using Euro Medium Term Note (MTN) programs. This will be achieved through greatly simplified disclosure documents and procedures, resulting in a wider issuance window for issuers.

The TOKYO PRO-BOND Market will also, for the first time, allow English language documentation to be used enabling non-Japanese companies to issue bonds in Japan at much lower cost. Furthermore, a tax exemption on bond holdings for non-residents, implemented in June 2010, is expected to attract foreign investors to this market.

The creation of a bond market for professional investors is a central part of the Japanese government’s “New Growth Strategy,” approved by the Cabinet in June 2010, and one of the measures to be implemented during fiscal year 2010. It is also a subject under discussion at the Asian Bond Market Forum (ABMF) established by the governments of the ASEAN+3 countries.

The president and CEO of TOKYO AIM, Tetsutaro Muraki, commented: “The TOKYO PRO-BOND Market will act as a pivotal element in the development of Japan’s capital market. Through our discussions with potential issuers, investors, investment banks and other related parties, we believe that there is an intrinsic demand that is currently not being served in the region. With this new bond market, TOKYO AIM will contribute further to capital flow into Japan and Asia and support stronger economic growth in the region.”

This outline framework for the TOKYO PRO-BOND Market will be open for public consultation from November 10 to December 9, 2010.

– Ends –

Contacts for further information:
Kreab Gavin Anderson
+81-3-5404-0640 (Minako HATTORI; Masako OKURA; Ami TAKAGAWA)
About MTNs:
MTN is an abbreviation for “medium term note,” and refers to bonds issued in accordance with an MTN program, which is the most common way of issuing corporate bonds in the Euromarket. Under an MTN program, issuers conclude a basic agreement with several dealers prior to the issue of a series of bonds so that they can issue bonds flexibly according to their financing needs. MTN programs are typically listed on the London Stock Exchange, Luxembourg Stock Exchange and other exchanges.

About the New Growth Strategy:
The “New Growth Strategy – Blueprint for Revitalizing Japan” was approved by the Cabinet on June 18, 2010. It includes in its financial strategies the aim to realize a “Strong Economy.” As one of the measures to be implemented during fiscal 2010, the strategy lists the “establishment of a market infrastructure for the issuance and trading of bonds by professional investors, in order to create a financial market in Japan on par with the Euromarket.”

About the ABMF (ASEAN+3 Bond Market Forum):
The Asian Bond Markets Initiative (ABMI) was established in 2003 following the ASEAN+3 (Japan, China and South Korea) Finance Ministers Meeting, in response to the lessons of the 1997 Asian currency crisis. Its aim is to link Asian savings to Asian investment to achieve further development of the Asian economy. Under this framework, countries cooperate to promote diversification of bond issuers and bond issues denominated in local Asian currencies, as well as the establishment of an infrastructure and other elements to nurture bond markets. The ASEAN+3 Bond Market Forum (ABMF) was established in September 2010 as a common platform to foster standardization of market practices and harmonization of regulations relating to cross-border bond transactions in the region. The establishment of a bond market for professional investors is one of its important themes.

About TOKYO AIM, Inc.:
TOKYO AIM, Inc. was jointly established in 2009 by the Tokyo Stock Exchange Group, Inc. (51%) and the London Stock Exchange plc (49%). TOKYO AIM, the equity market for professional investors which it operates, is modeled on the London Stock Exchange's AIM system, employing a new structural framework and providing companies in Japan and Asia with a new venue for capital raising. The TOKYO PRO-BOND Market will be established alongside the TOKYO AIM stock market under TOKYO AIM, Inc. TOKYO AIM Website: http://www.tokyo-aim.com
**I. Objective**

- The Exchange will establish the Listing System as outlined below for bonds on the TOKYO PRO-BOND Market.

### Remarks

- The Bond Market for Professionals will be a Specified Financial Instruments Market as prescribed in Article 2, Paragraph 32 of the Financial Instruments and Exchange Act (Article 25 of the act of April 23, 1948) hereinafter referred to as the “Act”.
- The TOKYO PRO-BOND Market will be operated by TOKYO AIM, Inc. as a different market from the TOKYO AIM stock market.
- The types of securities that may be listed on the TOKYO PRO-BOND Market are as follows.
  - **Straight Bonds**: Corporate Bonds listed in Article 2, Paragraph 1, Item 5 of the Act (including bonds issued by mutual companies), but excluding bonds with warrants (as prescribed by Article 2, Paragraph 22 of the Companies Act).
  - **Bonds Issued by Government Agencies**: Bonds issued by legal entities pursuant to the special laws listed in Article 2, Paragraph 1, Item 3 of the Act.
  - **Bonds Issued by Funds**: Investment corporation debentures and those foreign investment securities that are similar to investment corporation debentures, as prescribed in the Act on Investment Trusts and Investment Corporations, as outlined in Article 2, Paragraph 1, Item 11 of the Act.
  - **Municipal Bonds**: Municipal Bonds listed in...
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<thead>
<tr>
<th>Items</th>
<th>Contents</th>
<th>Remarks</th>
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<tbody>
<tr>
<td></td>
<td><strong>Article 2, Paragraph 1, Item 2 of the Act.</strong>&lt;br&gt;• Specified Company Bonds: Specified Company Bonds prescribed in the Act on the Liquidation of Assets listed in Article 2, Paragraph 1, Item 4 of the Act.&lt;br&gt;• Securities or notes issued by foreign countries or foreign entities: Those maintain the qualities of the above.</td>
<td></td>
</tr>
<tr>
<td>II. Listing System</td>
<td>1. New Listings&lt;br&gt;a Initial Listing Application</td>
<td>1. The listing of bonds on the TOKYO PRO-BOND Market will be carried out through an application by issuers.&lt;br&gt;2. The Initial Listing Applicant will submit an Initial Listing Application and Initial Listing Application Documents to the Exchange by the time of listing.&lt;br&gt;3. The Initial Listing Applicant will disclose Specified Securities Information (specified securities information prescribed in Article 27-31 of the Act) at the time of an initial listing of bonds.&lt;br&gt;4. It will not be necessary to retain a nominated adviser (J-Nomad) in the TOKYO PRO-BOND Market.&lt;br&gt;5. The Initial Listing Applicant may consult or make inquiries to the Exchange prior to listing regarding the Initial Listing Application.&lt;br&gt;6. The Initial Listing Applicant shall state in the Initial Listing Application Documents that there are no false statements in the Documents.&lt;br&gt;7. Specified Securities Information will be prepared based on the format stipulated by the Exchange.&lt;br&gt;8. The language of disclosure of Specified Securities Information will be either Japanese or English, or both.&lt;br&gt;9. Specified Securities Information will be comprised of: (1) Program Information (equivalent to the shelf registration documents under the Act); and (2) Personal Information (equivalent to supplemental shelf registration documents).</td>
</tr>
<tr>
<td>Items</td>
<td>Contents</td>
<td>Remarks</td>
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<tr>
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<tr>
<td><strong>b Qualification Requirements for Initial Listing Companies</strong></td>
<td></td>
<td>documentation). (It will be possible to include the content of program information in personal information, or for the information to consist of personal information only).</td>
</tr>
<tr>
<td></td>
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<td>The format of Specified Securities Information ((1) Program Information; and (2) Personal Information) will be discussed and decided at a later date, in accordance with the formats for shelf registration documents and supplemental shelf registration documentation in the Act.</td>
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<tr>
<td></td>
<td></td>
<td>Financial Information will be in a format that makes reference to the Program Information and the Issuer Filing Information.</td>
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<tr>
<td></td>
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<td>If the Initial Listing Applicant is a continuous disclosure company (a company which has submitted the Annual Securities Report for one year), the Act stipulates that announcement of Issuer Filing Information is not required and that Specified Securities Information ((1) Program Information; and (2) Personal Information) shall contain a notice that the company submits the Annual Securities Report.</td>
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<tr>
<td></td>
<td></td>
<td>Discussions and decisions regarding disclosure formats in English will be carried out with reference to systems such as the Euro-market.</td>
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<td>A credit rating for the above-mentioned Program Information may be used as the</td>
</tr>
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</table>

- The Initial Listing Applicant must satisfy all of the requirements listed below when listing bonds on the TOKYO PRO-BOND Market:

1. The said bonds obtain a credit rating from a credit rating agency (a credit rating agency as prescribed in Article 2, Paragraph 36 of the
<table>
<thead>
<tr>
<th>Items</th>
<th>Contents</th>
<th>Remarks</th>
</tr>
</thead>
<tbody>
<tr>
<td>c Approval of Listing</td>
<td>• Once it has confirmed that the Initial Listing Applicant satisfies the Requirements for Initial Listing, the Exchange will approve the listing of the bonds and publicly announce it in a timely fashion.</td>
<td>• Any securities company that wishes to register to appear on the Managing Underwriter List can apply to do so to the Exchange. The Exchange will then decide whether to approve the registration based on consideration of the company’s track record in corporate bonds underwriting. The Exchange will also assess the ongoing eligibility of securities companies to be included on the Managing Underwriter List. The requirements for companies registered on the Managing Underwriter List will be different to those for J-Nomads in that they will have no duties to the Exchange in respect of the Qualification Requirements for Initial Listing Companies and no post-listing duties. • In instances where it is deemed that listing the bonds in the said listing application would damage the reputation of the TOKYO PRO-BOND Market, or there is potential for the disruption of smooth market operations, the Exchange will not approve the listing.</td>
</tr>
<tr>
<td>2. Obligations after Listing a Timely Disclosure</td>
<td>• The issuer of listed bonds must disclose the Issuer’s Information in a timely, accurate, fair and investor-oriented manner.</td>
<td>• The matters that the issuer of listed bonds will be required to disclose will be different from that required for equity listings. The issuer of listed bonds will only be required to disclose matters such as dissolution, bankruptcy or default. Disclosure of other</td>
</tr>
<tr>
<td>Items</td>
<td>Contents</td>
<td>Remarks</td>
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<tr>
<td>-------</td>
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</tbody>
</table>
| b Financial Information | • The issuer of listed bonds will publicly announce Issuer Filing Information (Issuer Filing Information as prescribed in Article 27, Paragraph 32 of the Act) at least once per year. | information will be optional.  
• Note: Legally, in the case of corporate bonds, the important matters subject to insider trading regulations are limited to dissolution, bankruptcy or default (Article 6, Paragraph 6, Item 6 of the Financial Instruments and Exchange Act, Article 32-2 of the Enforcement Order of the Financial Instruments and Exchange Act, and Article 58 of the Cabinet Order on Regulation of Trading of Marketable Securities.  
• Timely disclosure obligations will not be imposed on sovereign debt issuers.  
• The details of Issuer Filing Information will be considered and decided at a later date.  
• If the issuer of listed bonds is a continuous disclosure company, the issuer of listed bonds is not required to announce Issuer Filing Information under the Act. |
| 3, Delisting, etc. | a Delisting other than by Application | • In instances where nondisclosure of required disclosure documents, serious false statements and other events occur for which the Exchange deems delisting appropriate, the Exchange will delist the said listed bonds.  
• In instances deemed necessary, the Exchange will take warning measures, or impose a penalty or other means on the issuer of listed bonds, and if deemed necessary may publicly announce this measure. |
| b warning measures, etc. | • | |
| 4, Listing Fees | • Listing Fees to be paid by the issuer of listed bonds to the Exchange will be charged on the registration of Program Information and listing of the bonds. | • The specific levels will be discussed and decided at a later date. |
# TOKYO PRO-BOND Market: Trading System and Settlement and Clearance System

November 10, 2010  
Tokyo AIM, Inc.

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<thead>
<tr>
<th>Items</th>
<th>Contents</th>
<th>Remarks</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Trading System</td>
<td>The Exchange shall prepare a trading system as outlined below for the conduct of trading in bonds in the TOKYO PRO-BOND Market.</td>
<td></td>
</tr>
<tr>
<td>(1) Form of Orders</td>
<td>The Exchange will accept ask and bid orders from Trading Participants.</td>
<td></td>
</tr>
<tr>
<td>(2) Order Acceptance Hours and Trading Hours</td>
<td>The order acceptance hours and the trading hours shall be from 9:00 to 11:00 and from 12:30 to 15:00.</td>
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</tr>
<tr>
<td>(3) Types of Transactions</td>
<td>The types of transactions shall be Regular Transactions.</td>
<td></td>
</tr>
<tr>
<td>(4) Method of Closing Trades, etc.</td>
<td>A lower sell quote shall have precedence over higher sell quotes, and a higher buy quote shall have precedence over lower buy quotes. Where two or more bids or offers are made at the same price, precedence shall be determined in the order of the time at which such bids or offers were made.</td>
<td>For foreign-currency-denominated securities, we will attach trading value information denominated in yen with the execution notice.</td>
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<tr>
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<td>The price will be determined by Zaraba (continuous session) method.</td>
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<td></td>
<td>Orders shall be conducted by simple methods such as email.</td>
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<tr>
<td></td>
<td>The unit for bid and ask prices shall be ¥0.01 for yen-denominated securities. The Exchange will determine the unit for bid and ask prices for each foreign-currency-denominated security.</td>
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<tr>
<td>(5) Order Method, etc.</td>
<td>Trading Unit shall be Face value ¥100 million for yen-denominated securities and Face Value for foreign-currency-denominated securities.</td>
<td>Real-time transmission using the TSE's Market Information System (MAINS) of total daily trading volumes on the TOKYO PRO-BOND Market will not be conducted.</td>
</tr>
<tr>
<td>(6) Trading Unit</td>
<td>Trading Information will be announced shortly after the trading, on the website of the Exchange. (For foreign-currency-denominated securities, the trading value converted into yen will also be announced.)</td>
<td></td>
</tr>
<tr>
<td>(7) Announcement of Trading Information</td>
<td>The Exchange Rate to convert foreign-currency-denominated securities</td>
<td></td>
</tr>
</tbody>
</table>
### Items

<table>
<thead>
<tr>
<th>Items</th>
<th>Contents</th>
<th>Remarks</th>
</tr>
</thead>
</table>
| (8) Notification of Orders   | into yen will be announced on the website of the Exchange before the start of the trading session.  
  • The Exchange will notify detailed particulars on orders (the name of the security, bid or ask, quote price, quantity) utilizing simple methods such as email.  
  • Trading fees will be charged on both selling and buying trading participants at the matching of orders.  
  • The Bond Market will be offered to Qualified Institutional Investors, et al who are not subject to Separate withholding in Interest Income Taxes and to Nonresidents, et al who are exempted from Interest Income Taxes. | • The specific levels will be discussed and decided at a later date.                                               |
| (9) Trading Fees            |                                                                                                                                                                                                      |                                                                  |
| (10) Investors              |                                                                                                                                                                                                      |                                                                  |
| 2. Clearance and Settlement System | Clearing with respect to trading of bonds in the TOKYO PRO-BOND Market will be handled by Japan Securities Clearing Corporation.  
  • Settlement with respect to trading of bonds in the TOKYO PRO-BOND Market will be handled by The Book-entry Transfer System for Corporate Bonds of Japan Securities Depositary Center, Inc. | • Clearing and settlement of foreign-currency-denominated securities will be dealt with by the trading value we converted into yen.  
  • The settlement will be subject to Non-DVP arrangement.  
  • As for bonds which are not handled by Japan Securities Depositary Center, Inc., trading participants who are involved in the transactions will clear and settle them directly. |

ENDS
Asian Funds Passporting

Client Webinar
29 November 2010

Hon Cheung
Regional Director
Official Institutions Group in Asia

Catherine Simmons
Vice President
Industry, Regulatory and Government Affairs
Agenda

Is it Time for an Asian Funds Vehicle?

What Would an Asian Funds Passport Do?

Key Challenges in Establishing an Asian Funds Passport

Why Now?

Lessons from UCITS

Lessons from PAIF

The Way Forward
Is it Time for an Asian Funds Vehicle?

- No cross-border fund vehicle in the region and limited cross-border recognition of products
- Easier to offer EU-regulated UCITS products in the region than a product from one regional jurisdiction to another
- Penetration of UCITS products in some regional markets suggests fund passporting can work if regulators are comfortable
- Lack of penetration of UCITS products in other markets suggests an alternative to UCITS is needed to unlock regional funds
- Asian Funds Passport might give regulators the comfort they need to increase cross-border recognition of regional products
Is it Time for an Asia-Pacific Funds Vehicle?

Cross-Border Fund Registrations in Asia Pacific: Distribution Markets and Fund Domiciles

<table>
<thead>
<tr>
<th>Country</th>
<th>Luxembourg</th>
<th>Ireland</th>
<th>UK</th>
<th>Other Domiciles</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Singapore</td>
<td>2,300</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Hong Kong</td>
<td>1,209</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Taiwan</td>
<td>837</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Macau</td>
<td>579</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Korea</td>
<td>250</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Japan</td>
<td>77</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Australasia*</td>
<td>59</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

*Includes Australia, New Zealand and Cook Islands

Source: PricewaterhouseCoopers, Global Fund Distribution 2010
What Would an Asian Funds Passport System Do?

- Promote development of Asia-Pacific capital markets
- Develop domestic financial services sectors
- Give access to broader range of products using local expertise
- Potentially improve returns and reduce concentration risk
- Reduce cost of product manufacturing and investment
- Allow regulators to shape regulations surrounding Asian funds
- Assist regional managers better tap into funds from Europe and the US
- Create a regional brand that is more marketable than country brands
What Would an Asian Funds Passport System Do?

Asia Ex-Japan Collective Funds Assets Under Management by Domicile

US$ billions

<table>
<thead>
<tr>
<th>Year</th>
<th>Cross-border</th>
<th>Locally Domiciled</th>
</tr>
</thead>
<tbody>
<tr>
<td>2005</td>
<td>$453</td>
<td>$381</td>
</tr>
<tr>
<td>2006</td>
<td>$585</td>
<td>$490</td>
</tr>
<tr>
<td>2007</td>
<td>$985</td>
<td>$985</td>
</tr>
<tr>
<td>2008</td>
<td>$769</td>
<td>$689</td>
</tr>
<tr>
<td>2009</td>
<td>$1,024</td>
<td>$891</td>
</tr>
<tr>
<td>Mar-10</td>
<td>$986</td>
<td>$849</td>
</tr>
</tbody>
</table>

Source: Cerulli Associates, Asian Distribution Dynamics 2010, September 2010 (Numbers rounded)
Key Challenges in Establishing an Asia-Pacific Funds Passport

<table>
<thead>
<tr>
<th>National Interest</th>
<th>Perceived threat to national interest in individual jurisdictions</th>
</tr>
</thead>
<tbody>
<tr>
<td>Regulatory Barriers</td>
<td>Overcoming differences in regulations in each jurisdiction</td>
</tr>
<tr>
<td>Currency Issues</td>
<td>Lack of free convertibility and a unified currency and use of USD</td>
</tr>
<tr>
<td>Tax Concerns</td>
<td>Agreeing to treatment of foreign investors and amending tax regulations</td>
</tr>
<tr>
<td>Competing with UCITS</td>
<td>Offering something UCITS does not and creating incentives to establish the product</td>
</tr>
</tbody>
</table>
Why Now?

Current economic and political trends make Asian Funds Passporting more feasible than ever before

- Developed capital markets means more than one benefits
- High degree of regulatory convergence makes agreement easier
- Increased regional cooperation in financial services
- Projected growth of regional AUM creating critical mass
- Interest in strengthening local capital markets and cross-border flows
- Desire to improve returns and access a greater range of products
- EU and US investors interested in tapping into the region
- Increasing support for the idea among governments and industry
Why Now?

Asia-Pacific Collective Funds Market: Estimated Total Assets of $3.9 Trillion

*Includes Malaysia, Hong Kong, Thailand, Singapore, New Zealand, Indonesia and Philippines

*As of December 31, 2009, Sources: Cerulli Associates, Investment Company Institute, Industry Associations and State Street estimates
Why Now?


<table>
<thead>
<tr>
<th>Country</th>
<th>2009 (US$ billions)</th>
<th>2014E (US$ billions)</th>
<th>Projected 5 Year CAGR</th>
</tr>
</thead>
<tbody>
<tr>
<td>China</td>
<td>$381</td>
<td>$776</td>
<td>15.3%</td>
</tr>
<tr>
<td>India</td>
<td>$147</td>
<td>$269</td>
<td>12.9%</td>
</tr>
<tr>
<td>Korea</td>
<td>$274</td>
<td>$481</td>
<td>11.9%</td>
</tr>
<tr>
<td>Taiwan</td>
<td>$122</td>
<td>$209</td>
<td>11.4%</td>
</tr>
<tr>
<td>Hong Kong</td>
<td>$58</td>
<td>$98</td>
<td>11.2%</td>
</tr>
<tr>
<td>Singapore</td>
<td>$22</td>
<td>$36</td>
<td>10.1%</td>
</tr>
</tbody>
</table>

Lessons from UCITS

What is UCITS?

- Undertakings for Collective Investment in Transferable Securities (UCITS)
- Collective investment funds that have been established in accordance with the EU UCITS Directive
- Can be marketed across the EU including to retail investors once registered
- Widely used by European households and sold to investors outside the EU

UCITS’ Success

- Accounted for 75 percent of the total European fund market at the end of June 2010
- Luxembourg and Ireland are leaders in the passporting of UCITS funds across borders
- Other European countries have also benefitted from the development of UCITS products
- In some markets, UCITS products are domiciled and sold primarily in the national market rather than passported across borders
### Lessons from UCITS

#### UCITS Market: Top 10 European Domiciles by Total Net Assets

<table>
<thead>
<tr>
<th>Country</th>
<th>Net Assets (EUR billions)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Luxembourg</td>
<td>1,724</td>
</tr>
<tr>
<td>France</td>
<td>1,211</td>
</tr>
<tr>
<td>Ireland</td>
<td>682</td>
</tr>
<tr>
<td>UK</td>
<td>591</td>
</tr>
<tr>
<td>Germany</td>
<td>228</td>
</tr>
<tr>
<td>Italy</td>
<td>184</td>
</tr>
<tr>
<td>Switzerland</td>
<td>182</td>
</tr>
<tr>
<td>Spain</td>
<td>172</td>
</tr>
<tr>
<td>Sweden</td>
<td>135</td>
</tr>
<tr>
<td>Belgium</td>
<td>87</td>
</tr>
</tbody>
</table>

Lessons from PAIF

What is PAIF?

- The ABF Pan Asia Bond Index Fund (PAIF)
- Exchange-traded bond fund investing primarily in local currency government and quasi-government bonds in eight Asian markets
- Domiciled in Singapore and listed in Hong Kong and Japan
- Perhaps the only regionally domiciled large fund offering that can be offered across a wide range of Asian jurisdictions

Key Learnings

- Cross-border recognition across several jurisdictions has been successfully done before and can be done again
- Regulators must cooperate to overcome regulatory and administrative barriers
- Cooperation is possible when governments are motivated to act together
- Can begin with only a few jurisdictions
The Way Forward

- Difficult to achieve agreement amongst all markets at once
- Begin with mutual recognition of a regional funds product by a few jurisdictions
- Use USD for fund settlement
- Encourage other jurisdictions to join once the vehicle becomes more established
- Keep the products simple and start with traditional asset classes
- Introduce separate regulations rather than adopt existing national regulations
- Examine a link between the regional passporting regime and UCITS in the longer term
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Investment involves risk and investors should read the prospectus including the risk factors carefully before investing. The listing of PAIF on the stock exchanges does not guarantee a liquid market for the units, and PAIF may be delisted from the stock exchanges.

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Asian Funds Passport to Growth

Across the Asia-Pacific region, interest is growing in the cross-border recognition of registered funds, which would give investors access to a broader range of locally manufactured and regionally distributed products. Establishing a mutually recognized regional funds vehicle would help streamline cross-border recognition, while also encouraging the development of the funds industry across the region.

Bringing such an Asian Funds Passport regime to fruition would require unprecedented cooperation among a fragmented and largely emerging market. Yet with the region’s already considerable assets under management increasing, major markets such as China developing quickly, and cooperation between governments and regulators improving, the time to create an Asia-Pacific passporting vehicle has never been better.
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With operations in 25 countries serving clients in more than 100 geographic markets, our global reach, expertise, and unique combination of consistency and innovation help clients manage uncertainty, act on growth opportunities and enhance the value of their services.

*As of September 30, 2010
The Case for Developing an Asian Funds Passport

With an estimated US$3.9 trillion in collective fund assets (see Figure 1) and strong regional growth predicted for the foreseeable future, many are asking if the time has come to develop a funds vehicle for registered funds in the Asia-Pacific region that can be recognized across borders. Often referred to as an Asian Funds Passport, the idea of passporting registered funds is certainly challenging, but appears increasingly feasible. Successfully creating an Asian Funds Passport has the potential to yield significant benefits in terms of cost savings, capital market development and local regulatory oversight.

The idea of Asian funds passporting is not new, but its implementation has previously been considered impossible because of the varying levels of development in the region’s markets, the significant competition among those markets to be financial centers, and the absence of a common currency and regulatory framework. Today, that perception is changing and the concept is gaining new momentum, particularly following the November 2009 publication of an Australian government-commissioned report, which formally proposed establishing a regional funds passport in Asia Pacific1.

Between the release of the Australian report and the confluence of several other factors, including recent initiatives on cross-border recognition, an increased convergence of regulations, more highly developed domestic capital markets and greater cooperation between regulators, the region appears to have reached

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a turning point, making Asian funds passporting more feasible than ever before. If the region succeeds in creating such a passport, it would bring numerous benefits to investors, regulators and capital markets more broadly.

For institutional and retail investors, a regional vehicle could provide access to a greater range of products that are locally manufactured, managed and administered. The products could draw upon local expertise and tap into the growth in regional economies. In smaller markets with limited investment options, access to a wider range of products across borders would potentially improve returns and reduce concentration risk. In addition, product manufacturing and investment costs would be reduced through economies of scale, since funds based in one domicile could be marketed and distributed in others across the region without having to create a full local presence in each country. The cost of the product might also be lower than that of offshore products currently offered from Europe due to the lower overall costs in the region’s countries.

Regulators would also get to shape the regulations surrounding an Asian funds vehicle. Asia-Pacific regulators have limited ability to influence the bulk of offshore funds currently used in the region; those funds are based on the European Union’s (EU) Undertakings for Collective Investments in Transferable Securities (UCITS). UCITS funds — registered vehicles, including equity-linked, balanced, bond and money market funds — are established in accordance with EU UCITS directives.

In addition, an Asia-Pacific funds vehicle could allow regional managers to better tap into and benefit from the expected inflow of funds from Europe and the United States. Investors outside the region could be offered exposure to a greater range of pan-Asian products developed within the region by regional experts. Today, Asia-Pacific products are often offered to European investors via UCITS framework products. While products are increasingly managed in regional countries, including through local offices of international fund companies, there is room for further growth in this area.

One of the key constraints in developing Asia-Pacific financial markets is that, despite flourishing intra-regional trade and significant progress in building up capital markets, including through the Asian Bond Markets Initiative (ABMI) and the Asian Bond Fund 2 Initiative, there is limited financial intermediation across borders in the region. This reality could negatively affect the region’s future capital market development.

The passporting initiative could help address these shortcomings by: 1) unlocking savings from banks and real estate investments through the creation of a viable domestic and cross-border fund industry to the benefit of businesses and governments in the region; 2) recycling Asian savings within Asian capital markets as well as outside Asia, rather than exporting the bulk of excess capital to Europe and North America, which could help to reduce global imbalances that are thought to have contributed to the recent global financial crisis; and 3) further developing the Asian capital markets and their local financial expertise through the introduction of efficient new products.

Indeed, although Asia Pacific has already made some progress in terms of cross-border vehicles, through products such as the ABF Pan Asian Bond Index Fund (PAIF) under the ABMI and the listing of US-listed exchange traded fund (ETF) products such as SPDR® Gold Shares, cross-border product recognition remains limited throughout the region. This is particularly true for funds.

In the absence of a regional alternative, offshore funds, including those using vehicles based on UCITS, have penetrated some markets in Asia Pacific. This acceptance in markets such as Hong Kong, Singapore and Taiwan suggests that Asia-Pacific regulators are open to the idea of a cross-border vehicle. Conversely, the lack of penetration of UCITS products in other regional markets suggests that the right vehicle has not yet been found. In Korea, for example, UCITS products initially proved popular, but then local incentives were implemented to encourage the growth of the local market. In other markets, such as India and China, the market is domestically focused.
A regional vehicle might provide the solution necessary for regulators to allow a regionally based cross-border or offshore funds industry to develop. Asia-Pacific countries would achieve greater benefits by working together. Having one country in the region try to go it alone and successfully sell its funds into other countries would be a less viable alternative to cooperating on a regional vehicle, particularly when competing against a global brand like UCITS.

This report examines the challenges involved in setting up an Asian funds passporting vehicle and explains why it might now be possible to turn the concept into a reality. It also outlines potential ways of doing so, drawing upon the lessons of the EU’s 25 years of experience with UCITS and, more locally, from the success of PAIF. While reaching an agreement on the regulatory structure for a passporting vehicle will not be easy across a region that is as diverse and fragmented as Asia Pacific, it does seem more possible than before. The difficulty will be in finding the best way to bring this idea to fruition.
The Asia-Pacific region poses unique challenges in terms of establishing any type of cross-border vehicle. The major differences between it and Europe, where the only other regional vehicles exist, are the absence of a corresponding regional rule-making body (the EU) and the lack of a common currency (the euro). As a result, compared to the EU, the region is somewhat fragmented and compartmentalized.

Despite a range of existing governmental organizations — including the Asia-Pacific Economic Cooperation (APEC), a forum for liberalizing and harmonizing regulations; the Association of Southeast Asian Nations (ASEAN), a political and economic grouping among Southeast Asian countries; and such entities as the Asia Pacific Committee of the International Organization of Securities Commissions (IOSCO), a grouping of the region’s securities regulators — there is no pan Asia-Pacific structure comparable to the EU. And given that Asia Pacific is not confined to one continent, but rather comprises numerous countries spread across multiple continents and oceans, each with its own political, economic and cultural interests, the emergence of an EU-type grouping, while certainly possible, seems unlikely in the foreseeable future.

The Asia-Pacific region’s fragmentation results in some of passporting’s key challenges, including currency issues, differing tax treatments, competition and varying levels of market maturity.

The lack of a regional currency and of convertibility in some jurisdictions certainly poses challenges. Inward and outward flows are complicated and the use of the US dollar as a settlement currency also potentially increases the cost of products due to foreign exchange conversions. However, investors in the region using UCITS products already have to deal with potential foreign currency risk associated with the euro. Using the US dollar rather than the euro may in fact benefit the Asia-Pacific region since it is already widely used and many local currencies are linked to it.

Tax is also a contentious issue both within and across borders. Governments would need to decide on how to treat foreign investors, i.e., should they be treated the same as local investors or receive concessions? Should tax be a competitive differentiator of countries involved in the passporting regime? Existing tax treaties may also need to be reviewed to account for any changes, and some jurisdictions may have to accept losses as part of the harmonization process.

Competition between jurisdictions is yet another obstacle within the region, as some jurisdictions may perceive funds passporting as a threat to their national interests. For example, larger, more established financial centers may fear that they will be giving an advantage away to competitors, while smaller investment centers might be afraid that they will be unable to compete with a regional product. However, as will be shown in examining the European example, more than one market can benefit from the development of a regional vehicle. Domestic fund regulation and products also sit side by side with regional regulations and products.

Another aspect of competition is the existing distribution of a large number of offshore — predominantly UCITS — funds in some Asia-Pacific countries. One of the challenges that will arise is the impact of an Asian Funds Passport on the region’s distribution infrastructure. As Figure 2 on the next page illustrates, Singapore
and Hong Kong are the leading markets in Asia Pacific for cross-border funds domiciled outside of the region, with 2,300 and 1,209 registrations, respectively, as of the end of 2009. An Asian regional product will need to compete with the existing UCITS brand and access distribution networks. UCITS managers currently have large sales teams in Asia selling their products. However, while some degree of competition may be inevitable, the current and expected growth in Asia Pacific is likely to be strong enough to absorb the introduction of an Asian Funds Passport, providing increased choice to the regions’ investors.

Expanding the Range of Products Offered

Progress has been made on the range of products offered in the region, which now include ETFs, real estate investment trusts and new structured products. However, the registered fund market is a notable gap in the development of capital markets in the region. It is still easier to register a UCITS product in Hong Kong and Singapore than it is to register a product from Hong Kong in Singapore or vice versa. Regulators in the region are more comfortable recognizing a European product than one from within the region. UCITS products come to market with an established pedigree that is broadly accepted, while bilateral recognition of new products between countries requires complex case-by-case negotiations.

As previously noted, there has been little substantive, practical progress toward allowing locally domiciled fund products to be made available across the Asia-Pacific region. Some mutual recognition agreements have been signed, but they have had limited real impact due to the difficulty of actually implementing the agreements.

Indeed, overcoming differences in regulations in each jurisdiction is one of the major challenges in establishing an Asian Funds Passport. Agreements would need to be reached on licensing, compliance, monitoring, disclosure, dispute resolution, appropriateness of products, investor protection and legal recourse. Reaching an initial agreement would be difficult, as would building consensus on the appropriate mechanisms to handle any issues that arise once the product is sold. Agreements are possible, however, when governments are motivated, as evidenced by the creation of PAIF described in Chapter IV of this report.

There are also differing levels of maturity across the region with regard to both markets and investors, which would affect the speed and the extent to which a passported vehicle could be adopted in some markets. The varying levels of market development also suggest that consensus on consumer protection will be an essential element in gaining acceptance for a cross-border vehicle.

Figure 2: Cross-Border Funds in Asia Pacific: Distribution Markets and Fund Domiciles

<table>
<thead>
<tr>
<th>Number of Cross-Border Fund Registrations</th>
</tr>
</thead>
<tbody>
<tr>
<td>Singapore</td>
</tr>
<tr>
<td>2,300</td>
</tr>
<tr>
<td>Hong Kong</td>
</tr>
<tr>
<td>1,209</td>
</tr>
<tr>
<td>Taiwan</td>
</tr>
<tr>
<td>837</td>
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<tr>
<td>Macau</td>
</tr>
<tr>
<td>579</td>
</tr>
<tr>
<td>Korea</td>
</tr>
<tr>
<td>250</td>
</tr>
<tr>
<td>Japan</td>
</tr>
<tr>
<td>77</td>
</tr>
<tr>
<td>Australasia*</td>
</tr>
<tr>
<td>69</td>
</tr>
</tbody>
</table>

*Includes Australia, New Zealand and Cook Islands
Source: PricewaterhouseCoopers, Global Fund Distribution 2010
Asia Pacific at a Turning Point

Despite the many challenges the Asia-Pacific region faces in creating a cross-border vehicle, developments in the region may make these obstacles surmountable and the emergence of a funds passporting vehicle more viable. The drivers behind this change include increased regional cooperation, a degree of regulatory convergence, the projected growth of the region’s assets under management, the desire to further develop and strengthen local capital markets and cross-border flows, and growing interest in the prospect of improved returns and access to a greater range of products.

Regulatory regimes are becoming increasingly similar, creating an environment in which the mutual agreement on the regulations necessary to establish an Asian passporting vehicle should be easier. For example, in reviewing domestic fund regulations in the wake of the financial crisis, Australia, Hong Kong and Singapore introduced similar measures relating to disclosure. This trend can partly be explained as the emergence of an international consensus on many basic principles. Regional countries’ membership in global regulatory bodies is also partly responsible. Six countries in the G20 are from the region, as are eight of the 24 countries in the Financial Stability Board (FSB). Japan and China participate in G8 meetings, and regional countries are increasing their presence in institutions like the International Monetary Fund (IMF) and the Asian Development Bank (ADB).

Cooperation between regional regulators outside of these global forums has also improved considerably in recent years. This trend is largely the cumulative result of the 1997 Asian financial crisis and the more recent global financial crisis, which have led to increased coordination and collaboration on a range of economic and financial regulatory matters within the region. Against this backdrop of consensus and cooperation, regulators have taken steps toward the cross-border recognition of products. Australia, for example, has concluded agreements with several countries, including one between the Australian Securities and Investments Commission (ASIC) and the Hong Kong Securities and Futures Commission on the cross-border offerings of retail funds. ASIC and the US Securities Exchange Commission have also concluded an agreement that impacts stock exchanges and broker-dealers, as have Singapore and Hong Kong with the United States.

Regional groupings have also begun to reach agreement on cross-border recognition. Within ASEAN there are now common ASEAN Standards and additional ASEAN Plus Standards, based on IOSCO, and International Financial Reporting Standards (IFRS) and the International Standards on Auditing (ISA) designed to facilitate cross-border recognition of listed products within ASEAN. Singapore, Thailand and Malaysia were the first three countries to sign on to the initiative.

Agreements have also been negotiated on the cross-listing of ETFs. Beyond the listing of US-based products such as the SPDR® Gold Shares ETF, the Taiwan and Hong Kong Exchanges have also agreed to cross-list ETFs, and the Hong Kong, Shanghai and Shenzhen Exchanges are discussing cross-listing ETFs between Hong Kong and China. Japan and Taiwan are also negotiating on cross-listing, and Korea and Thailand are trying to attract overseas ETFs.
In short, governments and regulators are communi-
cating more than before, both on a bilateral basis and
through international and regional forums such as the
G20, FSB and the ADB. All of these developments
point to an environment in which regional cooperation is
becoming increasingly prevalent and possible.

Funds Approaching Critical Mass

Just as cooperation is on the rise, so too are the assets
available in the region, providing the critical mass
necessary to develop a truly regional funds industry.
As Figure 3 shows, several emerging fund markets are
poised for double-digit annual growth over the next
five years in the collective fund assets under manage-
ment. If savings are moved from bank accounts, real
estate or other investments popular in the region into
collective vehicles due to the emergence of popular
domestic and cross-border fund products, these
numbers would increase dramatically.

This disbursement of assets across several markets in
the region suggests that multiple jurisdictions can be
expected to benefit from the further development of
a funds industry in the region and the existence of a
regional vehicle. Markets could develop strong onshore
fund industries and then use that expertise to export
products across borders.

Further support for the creation of an Asian pass-
port vehicle could come from the boost it can be
expected to give the local funds industry’s capabilities by
providing increased opportunities for a range of financial
professionals and support services personnel. A fully
developed funds industry requires people skilled in a
variety of areas ranging from creation and administration
of a domicile, fund management, law, accounting and
administration to transfer agency, custody, trustee and
client relationship services, among others. The leading
regional financial centers already have significant capa-
bilities they could build on. Other countries in the wider
Asia-Pacific region would also develop capabilities if they
were to play a part in the cross-border fund business.

Historically, regional investors have bought products
that were manufactured in the US and Europe, and they
still do. But as the market has matured, governments
in the region have invested a lot of money and effort in
building up their own financial services so that Asia can
now manufacture its own financial products. The next
logical step would seem to be the cross-border sale of
these funds.

The more developed financial markets in Asia Pacific
are well placed to reduce overall costs and provide
competitive products. Despite the differing currency
regimes, a locally domiciled product in one of the more
developed markets in the region would not necessarily
have any greater currency risk or transaction costs than
those associated with euro-based products sold in Asia
because, as previously noted, the US dollar is already
widely used in the region. Local cities offer low-cost
locations relative to Europe for support functions and,
in some cases, are already beginning to be used by
international financial institutions.
Lessons from UCITS and PAIF

In developing an Asian Funds Passport, regional regulators can draw upon important lessons, both from the creation and evolution of UCITS in Europe over the past 25 years and from the process of establishing PAIF in the Asia-Pacific region five years ago.

The EU had to overcome significant hurdles to bring UCITS to fruition. Although the EU has become a political unit, every country in Europe still maintains a different funds regulatory regime. Initially established in 1985, UCITS was conceived as part of the process of achieving regulatory harmony in a region where individual countries were seen as unlikely to accept a top-down harmonization package. Because of the challenges of trying to encourage these diverse countries to change their national regulations, Europe instead decided to create a new set of fund management directives that each of the countries could opt into.

Over the years, various iterations of UCITS have emerged, with UCITS IV set to go into effect in July 2011. UCITS has undoubtedly been a success for Europe, where the percentage of UCITS funds relative to non-UCITS funds is high, accounting for 75 percent of the €7.5 trillion total European fund market at the end of June 2010. In most European countries, UCITS-compliant funds have overtaken domestic fund structures, meaning that countries are increasingly choosing region-wide standards over local ones. This deep penetration demonstrates that European regulators and consumers are increasingly comfortable with the UCITS brand.

The key to UCITS’s success is that, although the funds are created in multiple countries, they are brought to market under a standardized and rigorous EU regulatory regime. The success of this approach makes it a useful model for the Asia-Pacific region.

Another useful lesson is the way in which a range of countries have benefited from UCITS by drawing on their individual strengths. Luxembourg and Ireland have emerged as key cross-border domiciles. In most cases, UCITS funds that are offered across borders are domiciled in these two jurisdictions, but are readily accepted in other individual countries. Importantly, under UCITS IV, the process for registering funds for sale in additional EU countries will be expedited once the host member state has authorized the product. This may encourage other countries to offer more cross-border funds.

Luxembourg, a well-established funds center, drew upon its traditional nimbleness when UCITS came into existence and succeeded in being faster and more flexible than its neighbors in adapting to the new directive. By contrast, Ireland had no track record in fund management, but got its start when, as part of an attempt by the government to promote urban renewal and job creation, it aggressively cut taxes to attract managers. The government made a decision to put itself up as a jurisdiction of choice, and succeeded in creating a substantial servicing industry.

There are clearly major advantages for any country in the Asia-Pacific region that achieves a first-mover role as a domicile in terms of establishing or strengthening its role as a leading financial center. However, UCITS also provides a useful lesson by demonstrating that more

than one jurisdiction can benefit from the adoption of a region-wide product. For example, although Luxembourg remains the leading UCITS product domicile with €1.72 trillion in net UCITS assets, the second-largest domicile is in fact France, which has €1.21 trillion in net assets, while the UK’s €590.9 billion in assets closely follows Ireland’s €682.4 billion in net UCITS assets, as shown in Figure 4.

Figure 4: UCITS Market: Top 10 European Domiciles by Total Net Assets

<table>
<thead>
<tr>
<th>Country</th>
<th>Net UCITS Assets (EUR billions)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Luxembourg</td>
<td>1,723.6</td>
</tr>
<tr>
<td>France</td>
<td>1,211.5</td>
</tr>
<tr>
<td>Ireland</td>
<td>682.4</td>
</tr>
<tr>
<td>UK</td>
<td>590.9</td>
</tr>
<tr>
<td>Germany</td>
<td>228.1</td>
</tr>
<tr>
<td>Italy</td>
<td>184.0</td>
</tr>
<tr>
<td>Switzerland</td>
<td>182.1</td>
</tr>
<tr>
<td>Spain</td>
<td>172.2</td>
</tr>
<tr>
<td>Sweden</td>
<td>135.4</td>
</tr>
<tr>
<td>Belgium</td>
<td>86.7</td>
</tr>
</tbody>
</table>

As of June 30, 2010
Source: EFAMA Quarterly Statistical Release No. 42, Second Quarter of 2010

Under an Asia-Pacific passporting regime, well-established financial centers such as Hong Kong and Singapore might want to focus on being domiciles for passported funds. Others, such as China and Japan, which have domestically focused markets, may want to follow the French example and use the regional product within their borders as a recognized set of standards, rather than for passporting internationally. Australia, given its substantial domestic funds market and well-developed financial market for international investors, might pursue a combination of both options. Custody and administration could be handled in low-cost centers.

PAIF’s Pioneering Example

PAIF, the Asia-Pacific cross-border bond product launched in 2005, also provides a useful example of how a cross-border financial vehicle can be successfully established in the region, and illustrates some of the challenges involved.

Managed by SSgA, PAIF is an ETF that primarily invests in local currency, and government and quasi-government bonds in China, Hong Kong, Indonesia, Korea, Malaysia, the Philippines, Singapore and Thailand. The fund is domiciled in Singapore and listed in Hong Kong and Japan. It is one of the only large, regionally domiciled funds that can be offered across multiple Asian jurisdictions.

Creating PAIF was no easy process and involved significant effort with local regulators to allow the fund to be launched and listed in different jurisdictions. These discussions often dealt with quite complex issues and, in some cases, required considerable effort from regulators for the product to be listed. In addition, each time the fund is cross-registered in other jurisdictions, attention must be paid to ensure that additional local compliance requirements are met. There were also additional costs related to new business units that were set up to meet regulatory requirements.
Despite these challenges, PAIF has undoubtedly been a success. Over the five years since its launch, PAIF has doubled its assets to US$2 billion and achieved an average annualized return of 6.96 percent as of June 30, 2010. The fund provides access to Asia’s local bond markets and is one of the only listed vehicles offering investors exposure to a diversified basket of Asian bonds in a single transaction.

PAIF sets a useful precedent for successfully achieving cross-border recognition across several jurisdictions in Asia. The key to its success was that regulators were motivated to cooperate to overcome the regulatory and administrative barriers to building regional bond markets. Similarly, passporting could help develop the registered funds market in the region if governments committed to this goal.

Perhaps most important, the lessons of UCITS and PAIF underscore that getting different national authorities to harmonize existing national regulations for a new product can be a protracted and complex exercise. To advance the concept in a timely manner an alternative may need to be found.
The key objective in establishing an Asian Funds Passport is to create a means for Asian investors to invest in products via a regionally created and regulated vehicle. Such a vehicle would strengthen financial intermediation within the region, while enhancing regional capital markets and deepening the skills and capabilities of participating markets. Regional governments would also be able to help shape the regulation of the offshore funds industry in the region.

An Asian Funds Passport vehicle is unlikely to take exactly the same form as UCITS, given the very different and more fragmented environment in the region and the lack of a unifying political-economic structure. But the strengths of UCITS can be used. An Asian vehicle could be based on non-controversial products and basic investor protections.

Establishing a common set of UCITS-type investment guidelines for Asian funds to be applied across all countries in the region could prove too challenging at this stage. In the interim, there are at least two possible options that could move the passporting concept forward in Asia: 1) gradually moving from a series of bilateral mutual recognition agreements to a multilateral framework, as suggested by the aforementioned November 2009 Australian report, or 2) getting a smaller group of leader countries to mutually agree to a new set of regulations for an Asian Funds Passport and subsequently encouraging others to adopt it, as Europe did for UCITS.

The report “Australia as a Financial Centre: Building on our Strengths,” under the chairmanship of the Australian Financial Centre Forum’s Mark Johnson, may lead to a more formal evaluation of a region-wide funds passport in Australia and the region. Although the government has yet to respond in detail, the report recommended that Australia initially approach launching a regional funds passport by negotiating bilateral agreements with jurisdictions with similar regulations, such as Singapore. Once several bilateral agreements have been established, those countries could be linked with multilateral agreements to form the basis of a regional agreement on a passporting regime.

However, bilateral mutual recognition agreements can take a long time to negotiate and are often not fully utilized in the market because of the practical difficulties of working with other regulatory regimes. For example, even with Australia’s current mutual recognition agreements, Australian funds are subject to top-up regulatory requirements in host regimes such as Hong Kong. On custody arrangements, the Australian approach differs from the UCITS framework, as do those of Hong Kong and Singapore, in that a single entity can be both fund manager and custodian of the fund’s assets in Australia, whereas under the other jurisdictions assets must be held by a custodian independent of the fund manager.3

An alternative and perhaps more feasible approach to bilateral mutual recognition takes the lessons of PAIF and UCITS into account; those experiences demonstrated how difficult it is to get countries to amend and harmonize existing regulations even when there is the political will to support such actions.

Based on this experience, a more viable way to move the Asian Funds Passport concept forward may be to have a few countries take the lead on developing and agreeing to regulations to create a cross-border fund product.

Under this scenario, there would be no need to set up a new region-wide regulatory structure like the EU or to try to mesh together existing domestic regulations. Instead of amending existing national funds regulations, an agreement could be reached on setting up a new and separate set of regulations for the passporting vehicle. This agreement could initially be limited to a small group of countries with similar regulatory and legal systems and established practices for manufacturing, selling, managing and regulating fund products. Other countries could then join once the vehicle became more established, provided they were prepared to introduce similar regulations domestically. Such has been the case with the APEC Travel Card, for example, a true passporting regime that facilitates the movement of people across borders in the Asia-Pacific region.

Several jurisdictions could take the lead on the issue. As noted, Australia formally raised the possibility of a regional passport concept through its November 2009 Report, and may be interested in approaching other governments on the initiative. Hong Kong might also be keen to support the concept given its desire to maintain and strengthen its role as a financial center within China. Singapore, one of the region’s most developed financial centers, could also play a role in the launch of the concept. Japan, Korea, Taiwan, Thailand and Malaysia might also be interested in participating in the future, as might China and India.

There is a strong case to be made for starting small with a few countries adopting a new mutually agreed regulatory regime, rather than attempting to harmonize existing regulations to accommodate passporting on a bilateral basis or obtain region-wide agreement. Whether or not a few leader countries will emerge to move the idea forward remains to be seen. But the opportunities offered by a cross-border regional fund are significant.

Great Potential to Move Assets into a Regional Product

Although offshore funds have done very well in some Asian countries, locally domiciled funds still dominate in the region. As shown in Figure 5, of the $986.4 billion in collective fund assets in Asia (ex Japan), $848.7 billion was held in locally domiciled funds. Hong Kong, Singapore and Taiwan lead the region in terms of cross-border fund penetration, whereas in Korea, India and China, cross-border funds have little or no presence. This dynamic suggests that there is significant potential for a regional cross-border product that could be pooled and promoted on a larger scale to multiple countries.

UCITS funds’ cost to market has historically been low compared to other products because they are an existing suite of products that are readily registered and accepted in Asia Pacific and benefit from economies of scale. However, costs are generally higher in Europe than the region so Asia-Pacific markets should be able to create competitive cross-border products more cheaply than Europe. There is also concern that costs will increase in conjunction with the next generation of UCITS regulations, making the product less attractive, particularly outside the EU.
UCITS cross-border products will likely still be offered and chosen by regional investors. But the chance of UCITS products dominating the funds industry of the future in the region is slim. Regional governments and regulators play a limited role in shaping the EU regulations that govern UCITS structures and can be expected to prefer an Asian passporting vehicle where they can shape the regulatory framework.

But launching an Asian Funds Passport will require commitment from governments. Getting the Asian passport concept onto the agenda of regional organizations will be one of the keys to building political consensus and momentum. The funds industry’s adoption of the vehicle will also be key. Incentives may be needed relating to tax and market access to get the new product off the ground. Regional fund organizations and other forums have already begun discussing the concept. This will need to continue for the idea to gain traction and understanding.

What Shape Should it Take?

The key challenge for cross-border products is how to interface with national regulatory regimes and how to protect consumers from potential risks. The UCITS stamp of approval has come to be seen as a basic benchmark of quality that has driven the acceptance of its products. Its success in some countries in the Asia-Pacific region demonstrates that countries are willing to accept passporting if the right vehicle exists. The issue in the region has been the lack of an appropriate vehicle.

One of the key lessons from the EU’s experience is that the structure for an Asia-Pacific vehicle should be kept as simple as possible, especially if it is ultimately going to be sold to retail investors. Regulators should look at all four iterations of the UCITS directives and take the best from each. Certain alternative asset strategies now available under the UCITS banner — so-called Newcits funds — have aroused concerns over possible investor protection issues in having complex products sold within the UCITS regime.4 The Asian passporting regulations will need to be framed — at the beginning, at least — in terms of traditional asset classes, rather than with the additional potential of more hedge fund-like strategies. Regulators might also feel more comfortable registering funds rather than adopting UCITS IV-style passporting. Funds would need to be registered in individual countries before being sold, but the approval processes would be streamlined for compliant funds and, as in Europe, a time limitation would be imposed for review and approvals to ensure that the process does not become too slow.

It is also important to note that whereas the EU member states are used to a centralized supervisory system via the EU, Asia is not, and will need to achieve mutual agreement on a country-by-country basis. That is another argument against adopting a bilateral approach, since such an approach can often leave a lot of space for nuanced agreements, potentially making future, wider-scale harmonization more difficult. Agreement on a set of mutually agreed regulations by several countries would provide a scalable option that could help fast track the cross-border offering of funds.

Several market trends suggest that the move toward a regional passport is inevitable. Financial markets and economies have evolved and strengthened over the past decade and the region’s resilience in the face of the global financial crisis suggests that this will continue. Regional cooperation between national regulators and governments has greatly improved.

A passporting vehicle offers a great opportunity to create benefits across Asia Pacific. Essential lessons can be drawn from the EU’s experience with UCITS, and the examples of pioneering Asia-Pacific cross-border products such as PAIF, to create a vehicle that could be effectively utilized across the region. It will be up to regional governments to decide whether now is the right time to make the passporting concept a reality. If it does become a reality, local, regional and global companies will need to substantially re-think their funds strategy in the region.

Proposed Action Plans for ABMF Sub-Forum 1 (SF1) - On Proposals Raised during Brainstorming Session

- Members to provide feedback or response to Co-chairs and ADB by **13 January 2011**

- **Review Committees (RC)** should be formed to consider proposals presented to SF1, and to deliver implementation plans (for ABMI Task Force 3):
  - RC to follow up on each identified proposals and focus on implementation aspects
  - Also, to evaluate and present detailed proposals to SF1 Meeting
  - To be led by Co-chairs of TF3 and SF1, with relevant coordination from ADB
  - Participants will comprise SF1 members who are preferably lead regulator or subject matter expert from each country
  - All SF1 members to participate in at least one RC
### Proposed Action Plans for ABMF Sub-Forum 1 (SF1) - On Proposals Raised during Brainstorming Session

- **Examples of RCs that could be formed:**

<table>
<thead>
<tr>
<th>No</th>
<th>Proposals</th>
<th>Remarks</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>New International CRA</td>
<td>Informal feedback from relevant market players in the region (on confidential basis) is relevant</td>
</tr>
<tr>
<td>2</td>
<td>Mutual recognition of credit rating</td>
<td>Interface with Chairs of ASEAN Capital Market Forum (ACMF) Working Groups to seek early feedback from securities regulators in ASEAN countries</td>
</tr>
<tr>
<td>3</td>
<td>Mutual recognition of offering documents and advisors (for bonds)</td>
<td>FX issues to be effectively addressed with all central bank representatives at ABMI TF Meetings</td>
</tr>
<tr>
<td>4</td>
<td>Asian Funds Passport</td>
<td></td>
</tr>
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