### DAY 1 - 30 JUNE 2011

<table>
<thead>
<tr>
<th>TIME</th>
<th>PROGRAM</th>
</tr>
</thead>
<tbody>
<tr>
<td>19:00 – 21:00</td>
<td><strong>Welcome Dinner</strong> (hosted by Korea Capital Market Institute (KCMI))</td>
</tr>
</tbody>
</table>

#### 30 June 2011: DAY 1: ABMF Sub-Forum 1

<table>
<thead>
<tr>
<th>TIME</th>
<th>PROGRAM</th>
</tr>
</thead>
<tbody>
<tr>
<td>08:20 – 08:40</td>
<td><strong>Registration</strong></td>
</tr>
<tr>
<td>08:40 – 08:50</td>
<td><strong>Welcoming Remarks by Dr. HyoungTae Kim, President, Korea Capital Market Institute (KCMI)</strong></td>
</tr>
</tbody>
</table>

**Part 1: Proposal for ASEAN+3 Cross-border Bond Market and Asian SRO**

<table>
<thead>
<tr>
<th>TIME</th>
<th>PROGRAM</th>
</tr>
</thead>
<tbody>
<tr>
<td>08:50 – 09:10</td>
<td><strong>Presentation by Dr. Suk Hyun, Research Fellow, KCMI</strong></td>
</tr>
</tbody>
</table>

**Dialogue with selected self-regulatory organizations (SROs) in the region**

- Facilitating collaboration among self-regulatory organizations in the region
- Promoting conducive standards and practices for issuance and trading of bonds among regulatory/supervisory authorities and self-regulatory organizations in the region

*Presentation by selected SROs from Plus3 countries:*

- **Mr. SungHwan Yoon**  
  Manager, Korea Financial Investment Association (KOFIA)
- **Mr. Ryuichi Shiina**  
  General Manager, Japan Securities Dealers’ Association (JSDA)
- **Mr. MinSuk Lee**  
  Manager, Korea Exchange (KRX)
- **Mr. Yutaka Ito**  
  Chief Operating Officer, Tokyo Aim, Tokyo Stock Exchange (TSE)

*Overview on ASEAN*

- **Mr. Thomas Meow**  
  Executive Vice President & Head, CIMB Investment Bank

<table>
<thead>
<tr>
<th>TIME</th>
<th>PROGRAM</th>
</tr>
</thead>
<tbody>
<tr>
<td>10:45 – 11:00</td>
<td><strong>Coffee Break</strong></td>
</tr>
</tbody>
</table>

**Discussion: Role of SROs in ASEAN+3, Promoting conducive standards and practices**

- Comments from SROs from ASEAN
- Next step (Asian version of Eurobond and Regulation S)
### Part 2: Proposal for ASEAN+3 Cross-border Securitization Market

<table>
<thead>
<tr>
<th>Time</th>
<th>Event</th>
</tr>
</thead>
<tbody>
<tr>
<td>11:30 – 12:00</td>
<td>Presentation by Dr. Pilkyu Kim, Research Fellow, KCMI</td>
</tr>
</tbody>
</table>
| 12:00 – 12:30 | **Discussion:** Facilitating and harmonizing securitization in the region  
                   - Dr. Seiwoon Hwang  
                     Research Fellow, KCMI  
                   Discussant: **Dr. Seung Jae Lee**  
                     Principal Financial Sector Specialist (FS), OREI, Asian Development Bank |
| 12:30 – 13:45 | Lunch Break                                                           |

### Part 3: Information collection update: Reporting by ADB consultants

<table>
<thead>
<tr>
<th>Time</th>
<th>Event</th>
</tr>
</thead>
</table>
| 13:45 – 14:00 | **Market consultation results and overall assessment**  
                   Presentation by: **Prof. Shigehito Inukai**                                |
| 14:00 – 14:30 | **Reporting on PRC, Indonesia, and Malaysia**  
                   Presentation by: **Prof. Shigehito Inukai**                                |
| 14:30 – 15:00 | Comments and questions from the members and experts                  |
| 15:00 – 15:30 | **Reporting on Thailand, Viet Nam, and Hong Kong, China**  
                   Presentation by: **Prof. Shigehito Inukai**                                |
| 15:30 – 16:00 | Comments and questions from the members and experts                  |
| 16:00 – 16:15 | Coffee Break                                                          |
| 16:15 – 16:45 | **Reporting on the Philippines, Republic of Korea, and Japan**  
                   Presentation by: **Prof. Shigehito Inukai**                                |
| 16:45 – 17:15 | Comments and questions from the members and experts                  |
| 17:15 – 18:10 | **Next step and work plan for SF1**  
                   - summary of the morning discussion (Role of SRO in the region  
                     and Asian version of common issue program)  
                   - roundtable discussion                                                      |
| 18:10 – 18:15 | Closing Remarks by SF1 Chair                                         |
| 19:00 – 21:00 | Dinner (hosted by Korea Exchange (KRX))                              |
Proposal for ASEAN+3 Cross-border Bond Markets and an Asian SRO
-The 4th ABMF Meeting-
Jeju Island, Korea

June 30, 2011

Suk Hyun
Research Fellow, Ph.D
Korea Capital Market Institute
hyun@kcmi.re.kr

Contents

I. Background
II. ASEAN+3 Cross-border Bond Markets
III. Asian SRO
I. Background

1. Lessons from the 1997/98 Asian Financial Crisis

The ABMI aims to:
- Avoid the double mismatch of maturity and currency
  Asian currencies denomination ↔ limited access to LCY markets
- Recycle more Asian savings into Asian economies
  Strengthen cross-border intermediary function ↔ lack of int’l bond markets
- Promote financial harmonization and integration in the region
  Asian Bonds Standard ↔ fragmented bond markets

Local Currency Long-term Lending

Foreign Currency Short-term Borrowing

Asian Financial Crisis
Double Mismatch
Absence of well-functioning bond market in the region
2. Lessons from the Global Financial Crisis

- **Asian Countries’ High Dependence on the US dollar.**
  - Asian countries had difficulty securing liquidity due to a dollar shortage in international financial markets during the global financial crisis.
  - The dominant role of the US dollar as a vehicle currency in cross-border transactions increases transaction costs for Asian countries.

- **Having experienced two financial crises, Asian countries now have incentives to reduce the excessive dependence on the US dollar, and to use their own currencies in international transactions.**

- **The ABMI’s initial stage focused on domestic bond market development to capitalize on domestic savings and address currency and maturity mismatch problems. For further development of Asian bond markets, another challenge for the ABMI is developing an efficient cross-border bond market in the region that channels the regional savings glut into regional investments.**

3. Premature Cross-border Function in Asia

- **The development of an international bond market, such as the Rule144A market and the Eurobond market and cross-border intermediary function in Asia is very premature.**

![Diagram showing the premature cross-border function in Asia.]

- **Asian Issuers**
  - To provide stable funds to Asian core fund raisers for economic growth in Asia
- **Asian Investors**
  - To bring appropriate investment opportunities to the abundant savings in Asia
- **Asian Cross-Border Bond Markets**
  - To enable the abundant savings in the region to be circulated efficiently within the region.
4. Further Development for Asian Bond Markets: International (cross-border) Bond Markets

<table>
<thead>
<tr>
<th>Bond Type</th>
<th>ASEAN5</th>
<th>Korea</th>
<th>Japan</th>
<th>UK</th>
<th>US</th>
</tr>
</thead>
<tbody>
<tr>
<td>International Bond</td>
<td>152.0</td>
<td>133.6</td>
<td>78.2</td>
<td>360.5</td>
<td>6,407.5</td>
</tr>
<tr>
<td>Government Bond</td>
<td>528.1</td>
<td>480.6</td>
<td>1,646.2</td>
<td>1,343.8</td>
<td>10,746.1</td>
</tr>
<tr>
<td>Financial Bond</td>
<td>74.0</td>
<td>271.9</td>
<td>879.7</td>
<td>1,206.4</td>
<td>321.9</td>
</tr>
<tr>
<td>Corporate Bond</td>
<td>128.5</td>
<td>336.1</td>
<td>505.2</td>
<td>855.9</td>
<td>21.3</td>
</tr>
</tbody>
</table>

Source: BIS Securities Statistics

5. ASEAN+3 Bond Market Forum (ABMF)

- The ASEAN+3 Bond Market Forum (ABMF) was established as a common platform to foster standardization of market practices and harmonization of regulations relating to cross-border bond transactions in the region.

- The ABMF is an important forum for bond market experts from both public and private sectors in the region.

→ What are cross-border bond markets?
→ Who will standardize market practices and harmonize regulations?
II. Asian Cross-border Markets

1. Definition of Cross-border Bond Markets

<table>
<thead>
<tr>
<th></th>
<th>Cross-border (International) bond markets</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Foreign bond market</td>
</tr>
<tr>
<td><strong>Regulation</strong></td>
<td>It is subject to domestic rules and regulations because it is part of a domestic market. (Arirang Bond, Samurai Bond, Panda bond)</td>
</tr>
<tr>
<td><strong>Currency</strong></td>
<td>Domestic currency</td>
</tr>
<tr>
<td><strong>Settlement</strong></td>
<td>Domestic CSD</td>
</tr>
<tr>
<td><strong>Cost</strong></td>
<td>High cost, many different regulations</td>
</tr>
</tbody>
</table>
2. The Current Situation of Asian Cross-border Bond Markets

- Asian currencies have different degrees of internationalization and convertibility. In general, cross-border bond issuance by countries with internationalized currencies such as Hong Kong, Singapore, Australia, and New Zealand has increased continuously. However, that of other Asian currencies has remained insignificant.

- Asian currencies’ inconvertibility resulting from FX controls and regulatory barriers between nations in the region makes them unsuitable for cross-border transactions. Under the current circumstances, currency mismatches cannot be addressed. Moreover, this restricts Asia’s efforts to facilitate further bond market development.

- The overall size of won-denominated bond issues has continued to grow. However, Korea’s laws and regulations related to foreign exchange transactions do not allow offshore currency transactions. This is why cross-border issuance, such as Arirang bonds and Euro-won bonds, remains small.

3. LCY Bond Issuance of Local vs. Cross-border (1)
4. LCY Bond Issuance of Local vs. Cross-border (2)

5. Proposal for Asian Cross-border Bond Market (1)

- **Qualified Issuers**
  - Quasi-government institutions
  - High-rating private companies

- **Qualified (Professional) Investors**
  - Institutional investors
    - (banks, pension funds, insurance)

**Asian Cross-border Bond Markets**

1. Offshore Market
2. Private Placement
3. Professional Market Players
4. Allowing Offshore Transaction of Asian Currencies

- CGIF
- RSI
- NICRA
- Asian Currency MTN program
First, the market needs to be defined as offshore because coordination of national regulations is too difficult.

Second, the market needs to be a private placement, which is based on peer to peer contracts and not subject to a single country’s jurisdiction, so as to avoid differences in disclosure rules and regulations across the region.

Third, the participating scope of the market should be confined to professional market players. It does not require full (strict) disclosure for the protection of retail investors.

Fourth, it is necessary to relax capital controls for offshore transactions under certain conditions. Currencies of countries participating in this offshore market should be partially liberalized.

The empirical results show that cross-border transactions don't increase the exchange rate volatility. Please refer to the Appendix1.

III. Asian SRO
1. Regulatory Tasks under the ABMI TF3

TF3: Improving Regulatory Framework

- Strengthening regulatory and supervisory framework for securities
- Facilitating collaboration among self-regulatory organizations in the region

Benefits of self regulation
- flexibility to adapt to rapidly changing financial markets
- less regulatory costs
- use knowledge and expertise of the markets and products

- Promoting conducive standards and practices for issuance and trading of bonds among regulatory/supervisory authorities and self-regulatory organizations in the region

2. Securities Regulations in Selected Countries

<table>
<thead>
<tr>
<th>Securities Supervisor</th>
<th>Other Relevant Securities Authorities</th>
<th>SRO (Exchange, Industry Association)</th>
<th>Structure of Financial Supervision</th>
</tr>
</thead>
<tbody>
<tr>
<td>China</td>
<td>CSRC, NDRC, CBRC, PBOC</td>
<td>NAFMII</td>
<td>Multiple</td>
</tr>
<tr>
<td>Indonesia</td>
<td>BAPEPAM, Bank Indonesia</td>
<td>BEI</td>
<td>Multiple</td>
</tr>
<tr>
<td>Japan</td>
<td>FSA</td>
<td>TSE, JSDA</td>
<td>Single</td>
</tr>
<tr>
<td>Korea</td>
<td>FSC, FSS</td>
<td>KRX, KOFIA</td>
<td>Single</td>
</tr>
<tr>
<td>Malaysia</td>
<td>SC, BNM</td>
<td>BMB, MIBA, ACI-Malaysia</td>
<td>Semi</td>
</tr>
<tr>
<td>Singapore</td>
<td>MAS</td>
<td>SGX</td>
<td>Single</td>
</tr>
<tr>
<td>Thailand</td>
<td>SEC, BOT</td>
<td>TBMA</td>
<td>Multiple</td>
</tr>
</tbody>
</table>


3. Regional Regulatory Framework for Asian Bond Markets

![Diagram showing Asian Bond Markets and various regulatory forums]

Source: TA report on Harmonization of Bond Standards in ASEAN+3 of Task Force 3

4. Two Approaches to Rules-setting in Cross-border Transactions: Statutory Regulation vs. Self Regulation

- **Two approaches to rule-setting**
  - Statutory Regulation: A forum for regulators, similar to the European Securities Markets Authority (ESMA), could be established to identify effective regulations that are consistent across jurisdictions.
    CESR → ESMA
  - Self Regulation: A forum for market participants like the International Capital Market Association (ICMA) could also be convened to set regional self-regulatory rules and standards in cross-border trading.
    AIBD → ISMA (+IPMA) → ICMA

- **The two approaches are complementary**

  - However, given the differences in capital market development and regulatory environments within the region, it might be better to use a Regional Forum for SROs among securities dealers’ associations, exchanges and market players as a starting point.
5. Establishment of an Asian SRO

- An Asian SRO designs and promotes bond standards in Asian cross-border markets.
  - In line with global best practices and standards
  - Facilitates cross-border capital flows and financial integration
- An Asian SRO is supported and endorsed by ASEAN+3 governments.

[Appendix 1]
1. Correlation between Cross-border FX Transaction and Exchange Rate Volatility
2. Empirical Results (Model 1)

**Model 1: cross-border FX transaction → exchange rate volatility**

\[
\ln \sigma_t = \beta_0 + \beta_1 \ln D_t + \beta_2 \ln GDP_t + \beta_3 \ln Inflation_t + \beta_4 \ln Government Debt_t + \epsilon_t
\]

<table>
<thead>
<tr>
<th>Variable</th>
<th>I</th>
<th>II</th>
<th>III</th>
<th>IV</th>
</tr>
</thead>
<tbody>
<tr>
<td>Constant</td>
<td>1.8754 ***</td>
<td>23.2791 ***</td>
<td>23.0554 ***</td>
<td>21.3803 ***</td>
</tr>
<tr>
<td></td>
<td>(0.4441)</td>
<td>(5.7145)</td>
<td>(5.3078)</td>
<td>(5.4027)</td>
</tr>
<tr>
<td>Cross-border FX Transaction</td>
<td>-0.6996 ***</td>
<td>-0.9151 ***</td>
<td>-0.7258 ***</td>
<td>-0.7729 ***</td>
</tr>
<tr>
<td></td>
<td>(0.2163)</td>
<td>(0.2321)</td>
<td>(0.2318)</td>
<td>(0.2252)</td>
</tr>
<tr>
<td>GDP</td>
<td>-3.4977 ***</td>
<td>-3.5427 ***</td>
<td>-3.7113 ***</td>
<td></td>
</tr>
<tr>
<td></td>
<td>(0.9279)</td>
<td>(0.8632)</td>
<td>(0.8517)</td>
<td></td>
</tr>
<tr>
<td>Inflation</td>
<td></td>
<td>0.0833 ***</td>
<td>0.0764 ***</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>(0.0218)</td>
<td>(0.0218)</td>
<td></td>
</tr>
<tr>
<td>Government Debt</td>
<td></td>
<td></td>
<td></td>
<td>0.5060</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td>(0.3259)</td>
</tr>
<tr>
<td>Observation</td>
<td>108</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

3. Correlation between Cross-border Issuance of LCY Bond and Exchange Rate Volatility
4. Empirical Results (Model 2)

Model 2: cross-border bond issuance → exchange rate volatility

<table>
<thead>
<tr>
<th>Variable</th>
<th>I</th>
<th>II</th>
<th>III</th>
<th>IV</th>
</tr>
</thead>
<tbody>
<tr>
<td>Constant</td>
<td>2.3572 ***</td>
<td>16.6012 ***</td>
<td>16.2109 ***</td>
<td>9.4177 **</td>
</tr>
<tr>
<td></td>
<td>(0.4914)</td>
<td>(4.5704)</td>
<td>(4.4783)</td>
<td>(4.4057)</td>
</tr>
<tr>
<td>Cross-border Bond Issuance</td>
<td>-0.8619 *</td>
<td>-0.8865 **</td>
<td>-0.8686 **</td>
<td>-0.7407 *</td>
</tr>
<tr>
<td></td>
<td>(0.4399)</td>
<td>(0.4390)</td>
<td>(0.4312)</td>
<td>(0.3802)</td>
</tr>
<tr>
<td>GDP</td>
<td>-2.3512 ***</td>
<td>-2.3192 ***</td>
<td>-2.3062 ***</td>
<td></td>
</tr>
<tr>
<td></td>
<td>(0.7506)</td>
<td>(0.7355)</td>
<td>(0.6962)</td>
<td></td>
</tr>
<tr>
<td>Inflation</td>
<td>0.0472 ***</td>
<td>0.0291 *</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>(0.0164)</td>
<td>(0.0162)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Government Debt</td>
<td></td>
<td></td>
<td></td>
<td>1.2194 ***</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td>(0.2244)</td>
</tr>
<tr>
<td>Observation</td>
<td></td>
<td></td>
<td></td>
<td>330</td>
</tr>
</tbody>
</table>

[Appendix 2]

SRO in the International Securities Market

- The Association of International Bond Dealers (AIBD) was established to create a framework of rules under which the over-the-counter Eurobond market could function, and to provide direction and stability to this rapidly changing market.

- In 1991, the AIBD was reorganized into the International Securities Market Association (ISMA), based in Zurich, is the self-regulatory industry body and trade association for the international securities market.

- The ICMA is a self-regulated trade association that plays an active role in the capital markets by influencing financial regulations in Europe. Based out of Zurich, Switzerland, it was created in July 2005 after the International Securities Market Association and the International Primary Market Association merged.
Thank you
Bond Market in Korea and KOFIA’s Role as an SRO

June 2011

Korea Financial Investment Association

Contents

I. Current status of the Korean bond market

II. Korea Bond Market Initiatives (Market development history)

III. KOFIA’s SRO Role in the Bond Market

- Primary Market
- Secondary Market
- Infrastructure
- Investor Protection

IV. Asian SRO
I. Current status of the Korean Bond Markets

1. Primary Market: Bond Issuance in Korea
2. Secondary Market: Trends in Bond Trading
3. Foreign Investment in the Bond Market

As of May, 2011, bond outstanding amounts to KRW 1,274 Trillion (≒ 1.16 USD Tril.) with government, financial, special and corporate bonds representing 30%, 20%, 20%, and 16% respectively.

(Unit: KRW Trillion, Source: KOFIA, KOSCOM)
I. Current status of the Korean Bond Markets

1. Primary Market: Bond Issuance in Korea (2005 ~ 2011.5)

In 2010, KRW 6,151 trillion (≒ 5.7 USD Trill.) worth of bonds were traded in Korean Bond Market.

2. Secondary Market: Trends in Bond Trading

In 2010, KRW 6,151 trillion (≒ 5.7 USD Trill.) worth of bonds were traded in Korean Bond Market.
I. Current status of the Korean Bond Markets

2. Secondary Market: Trading Volume Ratio

As of May 2011, government bonds are taking the biggest share at 58% of the total followed by MSB, financial bonds, and as for corporate bonds, it took a meager 3.1%.

Unit: KRW Trillion, Source: KOFIA, KRX

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2. Secondary Market: Trading Volume Ratio (OTC vs Exchange)

Most of the bonds (almost 90%) are being traded in the OTC markets.

Unit: KRW Trillion, Source: KOFIA, KRX
III. Korea Bond Market Initiatives

< Market development history >

<table>
<thead>
<tr>
<th>Date</th>
<th>Event Description</th>
</tr>
</thead>
</table>
| Dec. 1989 | Operation of the Council for Bond Issuance  
| May. 1993 | Disclosure of bond trading details in the OTC Market by KOFIA |
| Jul. 1993 | Collection and release of final quotation yields (8 types, 14 issues) |
| Nov. 1998 | Introduction of mark-to-market system, exclusively by KOFIA |
| Mar. 1999 | KTS(Electronic GB Trading System by KRX) launched |
| Sep. 1999 | Disclosure of benchmark yields for settlement prices of government bond rate futures |
| Jul. 2000 | Use of mark-to-market system across the board (assigned to 3 private companies)  
Continues disclosure yields by bond type and time to maturity.  
Improvement of Bond Information Disclosure System(B-TRIS)  
Real-time disclosure (within 30 min. -> 9 min. (July 2001) -> 15 min. (Dec. '02)) of trading details |
II. Korea Bond Market Initiatives

< Market development history>

<table>
<thead>
<tr>
<th>Date</th>
<th>Event</th>
</tr>
</thead>
<tbody>
<tr>
<td>Jul. 2002</td>
<td>Calculation and release of CP Index</td>
</tr>
<tr>
<td>Dec. 2002</td>
<td>Disclosure of benchmark yields for settlement prices of 364-d MSB rate futures</td>
</tr>
<tr>
<td>Jan. 2006</td>
<td>Calculation and release of Bond Market Survey Index (BMSI)</td>
</tr>
<tr>
<td>Dec. 2007</td>
<td>Centralization &amp; Disclosure of OTC Quotations (BQS)</td>
</tr>
<tr>
<td>Feb. 2009</td>
<td>Disclosure of Default &amp; Recovery Rate</td>
</tr>
<tr>
<td>Jun. 2009</td>
<td>Disclosure of Real-Time Bond Index (Treasury Bond)</td>
</tr>
<tr>
<td>Jan. 2010</td>
<td>Disclosure of Real-Time MSB Index</td>
</tr>
<tr>
<td>2010</td>
<td>BondMall launched (Feb.), FreeBond launched (Apr.)</td>
</tr>
<tr>
<td>Jul. 2010</td>
<td>Disclosure of Real-Time Money Market Index</td>
</tr>
<tr>
<td>Dec. 2010</td>
<td>Disclosure of Real-Time Credit Index</td>
</tr>
<tr>
<td>2011</td>
<td>QIB (Qualified Institutional Buyer) System being investigated by Government.</td>
</tr>
</tbody>
</table>

III. KOFIA's Role in the Bond Market

Primary Market
Secondary Market
Infrastructure
Investor Protection
III. KOFIA's Role in the Bond Market

Primary Market

1. Regulations on Securities Underwriting Business of KOFIA
   - Stipulate the Obligations of Underwriters to Protect Investors
     • SRO regulation, Maintain Order in the Primary Market
     • Regulate Business Practice among the Member Companies
   - Disclosure of Business Records of Managing Underwriter
     • Non-guaranteed Bonds & Stocks
     • Post the information on the web to be publicized
   - Standard Non-guaranteed Debenture Entrustment Agreement
2. Publication of Corporate Bond Issue Plan (Weekly)
   - Press Release, every Friday

3. Corporate Bonds Underwriting System being Reformed
   - Improve Business relationship of Issuing & Securities Com.
   - Substantive Due Diligence & Book Building
   - Radical Application of Rules and Reg. for Investor Protection
4. Expansion of Demand Base for Corporate Bond in Korea
   - QIB institution (system) to be implemented
   - Foster ‘Corporate Bond Concentrated Fund’, etc.
III. KOFIA’s Role in the Bond Market

Secondary Market

1. FreeBond
2. BondMall
3. Disclosure of OTC Trade Execution Details (15 Min. Rule)
4. Centralization & Disclosure of OTC Quotation
5. Bond Yields Disclosure

1. FreeBond (Bond Trading Support System)

   (Background) Replace the current trading method of private messenger in the bond OTC market with a formalized bond trading system, thereby advancing the Korean bond market

   ※ Reformation of Bond Trading Market (Oct. 6, 2009, FSC)

   (Definition) A system run by KOFIA which enables financial investment firms and major market practitioners to search bid/ask prices for trading and intermediation in the OTC bond market and supports trading negotiation with trading counterparts
III. KOFIA’s Role in the Bond Market

Secondary Market

1. FreeBond (Bond Trading Support System)

- **(Strengths)** convenience, specialization only for bond trading professionals, security, stability
- **(Components)** Consists of two: Trading-Board(T-Board), messenger
- **(Main Functions)**
  - T-Board: searching bid/ask prices, ordering, negotiation, confirming trade, providing real-time information on bid prices and analyses
  - Messenger: 1:N chatting, storing and using chatting frame lay-out, chatting room service
II. KOFIA's Role in the Bond Market

Secondary Market

2. Bond Mall

- **(Definition)** A website run by KOFIA, providing sales information of baby bonds of Securities companies.
  - Sales information of small-amount bonds by individual securities firms are collected into KOFIA real-time and provided for investors
  - Facilitating bond investment by individuals

III. KOFIA's Role in the Bond Market

Secondary Market

2. Bond Mall

- **(Main Functions)**
  - Efficient searching for bonds offered by securities firms
  - Price discovery function by bond types guaranteeing the highest profits
  - Enhance insight of the information users through bulletin board
  - Provide basic information on bond investment such as characteristics of bonds and risk factors
III. KOFIA’s Role in the Bond Market

- Bond Mall website (www.bondmall.or.kr)

3. Disclosure of OTC Trade Execution Details (15 Min. Rule)

- Securities firms have been required to report trading details to the KOFIA within 15 minutes after trading execution and the KOFIA discloses this information on its website (Since Dec. 2002)

  ✓ More than 4,000 daily disclosures on average, worth 20 ~ 25 trillion won in trading value.
  ✓ Enhancement of transparency in OTC bond trading
  ✓ Similar to the TRACE in US, the system for corporate bond price transparency (Trade Reporting And Compliance Engine)
III. KOFIA's Role in the Bond Market

- B-TRIS (Bond-Trade Report & Information Service)

4. Centralization & Disclosure of OTC Quotations

- KOFIA launched the BQS, an OTC Bond Quotation System that collects and disseminates all of the data pertaining to quote information on OTC trading. (Since Dec. 2007)

- More than 15,000 Bid/Ask Quotation disclosures on average (daily)

- Evaluate Quotes Report Result of each Securities Company

- Enhancement of transparency in OTC bond trading

- Lead to produce Real-time Bond Indices
### III. KOFIA’s Role in the Bond Market

#### BQS (Bond Quotation System; www.bqs.or.kr)

<table>
<thead>
<tr>
<th>Instrument</th>
<th>Bid</th>
<th>Ask</th>
<th>SPT</th>
<th>TTM</th>
<th>Time</th>
</tr>
</thead>
<tbody>
<tr>
<td>NH 1.5% 5.8YE</td>
<td>5200</td>
<td>5300</td>
<td>5000</td>
<td>5000</td>
<td>10:10</td>
</tr>
<tr>
<td>K. 1.5% 10.825YE</td>
<td>4900</td>
<td>5000</td>
<td>4900</td>
<td>4900</td>
<td>15:15</td>
</tr>
<tr>
<td>RN 1.5% 5.175YE</td>
<td>3450</td>
<td>3500</td>
<td>3400</td>
<td>3400</td>
<td>10:15</td>
</tr>
<tr>
<td>K. 1.5% 10.825YE</td>
<td>4900</td>
<td>5000</td>
<td>4900</td>
<td>4900</td>
<td>15:15</td>
</tr>
<tr>
<td>RN 1.5% 5.175YE</td>
<td>3450</td>
<td>3500</td>
<td>3400</td>
<td>3400</td>
<td>10:15</td>
</tr>
</tbody>
</table>

#### 5. Bond Yields Disclosure

- **Final quotation yields** for a specific time to maturity / by time to maturity
  - twice a day (11:30, 15:30)

- **Benchmark Yields for Final Settlement Price of Interest Rate Futures**
  - five times disclosure on futures’ final trading day (10:00, 10:30, 11:00, 11:30 and 15:00), twice a day (11:30, 15:30) on usual days

- **Provision of CP/CD issue information, Yield and Indices**
III. KOFIA’s Role in the Bond Market

- Monitoring Bond Pricing of Pricing Agency
- Evaluating CRAs’ rating abilities
- Real-Time Bond Index
- Disclosure of Specialized Bond Dealer Quotations
- Bond Market Survey Indices
- Bond Information Service (BIS)
- Miscellaneous Information Disclosure of the bond market
III. KOFIA's Role in the Bond Market

1. Monitoring Bond Pricing of Pricing Companies

- To enhance the reliability of bond pricing of pricing companies*
  * Korea Asset Pricing Inc., KIS Pricing Inc., NICE Pricing Service Inc.
- Monitoring average 11,000 bond prices a day on a monthly basis.
- Report the monitoring results to FSS and Publicize them to the Market.
- Commenced by FSS's request (Oct. '03), now Based on the KOFIA regulation.

2. Evaluating CRAs' rating abilities

- To enhance the reliability of Credit ratings of the local CRAs*(since 2000)*
  * Korea Investors Service, Korea Ratings, NICE Investors Service
- Evaluating the Local CRAs on a yearly basis by regulation.
- Qualitative (Survey by Market participants etc.) & Quantitative analysis.
- Publicize the evaluating results through Press release, so that Market participants make the use of them to choose CRAs.
III. KOFIA’s Role in the Bond Market

3. Real-Time Bond Index

- Yield real-time bond index based on KOFIA’s FreeBond which is used as a benchmark index for bond ETFs
- Understand real-time trends of the bond market
- **(Investor-side)** Facilitate spread trading between spot bonds and bond ETFs and enable investment in baby bonds
- **(Issuer-side)** Reduce capital-raising costs due to the increased demand
- **(Financial firms-side)** Use as a standard to evaluate investment performance and as a risk management index

---

Types of Real-Time Bond Index (6 types) / 8 Bond ETFs listed

<table>
<thead>
<tr>
<th>Index Name</th>
<th>Cycle</th>
<th>Source</th>
<th>First Disc.</th>
<th>Starting Index</th>
<th>Standard Point of Time</th>
</tr>
</thead>
<tbody>
<tr>
<td>MKF TB Index</td>
<td>30 Sec.</td>
<td>FreeBond</td>
<td>Jun. 09</td>
<td>100</td>
<td>'04. 6. 16</td>
</tr>
<tr>
<td>KTB Index</td>
<td>1 Min.</td>
<td>Collected by KRX, etc.</td>
<td>Jun. 09</td>
<td>10,000</td>
<td>'09. 6. 1</td>
</tr>
<tr>
<td>KEBI TB Index</td>
<td>5 Min.</td>
<td>FreeBond</td>
<td>Jul. 09</td>
<td>100</td>
<td>'09. 6. 30</td>
</tr>
<tr>
<td>MK MSB Index</td>
<td>1 Min.</td>
<td>FreeBond</td>
<td>Jan. 10</td>
<td>10,000</td>
<td>'10. 1. 1</td>
</tr>
<tr>
<td>MK MMI* Index</td>
<td>1 Min.</td>
<td>FreeBond</td>
<td>Jul. 10</td>
<td>10,000</td>
<td>'10. 6. 1</td>
</tr>
<tr>
<td>KOBI Credit Index</td>
<td>1 Min.</td>
<td>FreeBond</td>
<td>Dec. 10</td>
<td>10,000</td>
<td>'10. 9. 1</td>
</tr>
</tbody>
</table>

* MMI: Money Market Index (short term market)
4. Disclosure of Specialized Bond Dealer Quotations

- Specialized Bond Dealers were introduced in July 2000 to increase liquidity in the OTC market through market-making by each bond type.
- A total of 17 Primary Dealers (12 securities firms & 5 banks) disclose their buy/sell quotations on the KOFIA website.
- The KOFIA receives daily quotations from SBDs and discloses them on the website and on other online terminals.
5. Bond Market Survey Indices

- This Indices serve as warnings to detect potential risks in the bond market, thereby enabling market participants to systematically forecast market movements, credit risks, etc.
- quantified from the market forecasts of an opinion leader group comprising mainly of bond market insiders who are surveyed once a month.

<table>
<thead>
<tr>
<th>Index</th>
<th>Relevant Risks</th>
<th>Expected Effects</th>
</tr>
</thead>
<tbody>
<tr>
<td>BMSI</td>
<td>Interest rate risks</td>
<td>Predicts market direction</td>
</tr>
<tr>
<td>HHI</td>
<td>Credit risks</td>
<td>Distributes fund according to credit premium changes</td>
</tr>
<tr>
<td>MCRI</td>
<td></td>
<td>Strengthens bond market’s self-correcting and risk-managing capabilities</td>
</tr>
</tbody>
</table>

III. KOFIA’s Role in the Bond Market

- Bond Market Indices : BMSI
6. Bond Information Service (BIS) [http://www.kofiabond.or.kr]

- Provide the overall information of bond market, thereby enabling access for market participants, making bond trading more efficient, and thus facilitating efficient bond pricing.
- Comprehensive portal site for bond market information
- Gives foreign investors easy access to Korean bond-related information.
  (BIS English version website)
III. KOFIA’s Role in the Bond Market

7. Miscellaneous Information Disclosure of the bond market

- Disclosure of Default rate and Recovery rate (Since Feb. 2009)
- Enhance the price-discovery function of the high-yield bond market
- Publication of the Credit Rating information (Since Sep. 2003)
- Quick announcements & Comparison of the Rating Info through BIS
- Easy Access to the credit rating information of all the local CRAs
- Repo transaction information (for customer & between institutions)
- Bond Borrowing and lending transaction in the market

III. KOFIA’s Role in the Bond Market

Investor Protection

1. Standard Non-guaranteed Debenture Entrustment Agreement
2. Operates a Dispute Resolution Office
3. Training & Education for Financial Investment Professionals
4. Investor Education ; Establishment and Role of KCIE
III. KOFIA's Role in the Bond Market

Investor Protection

1. Standard Non-guaranteed Debenture Entrustment Agreement

- To protect bond investors through SNDEA
- ※ the Regulations on Securities Underwriting Business
- Set forth the roles and responsibilities of the Issuers and trustees, to enhance the reliability of the trustees
- Prescribe how to compensate the bondholders and how to hold the Meeting of bondholders, etc.
- In case of the event of defaults, based on the agreement, the trustee announces this information to the trust and KOFIA, which enables notification to all the investors

2. Operates a Dispute Resolution Office

- KOFIA resolves disputes between members of the Association and disputes related to the operation of financial investment business entities
- Such as investment trading, investment brokerage, collective investment business, investment advisory business, discretionary investment business and trust business.
- Dispute resolution committee (DRC) → Mediation plan to the parties
- Accepted Mediation plan ; Same effect as a judicial compromise
III. KOFIA's Role in the Bond Market

Investor Protection

3. Training & Education for Financial Investment Professionals

- The Korea Institute of Financial Investment (KIFIN), a subsidiary of KOFIA
  - Variety of training courses on financial investment instruments
  - Courses classified into general, professional, qualification and cyber training
- Korea Capital Market Seminar (annually since 2006)
  - Provide an opportunity for market practitioners, regulators and policy makers from emerging economies to learn Korea’s capital market experience
  - Lectures on various topic about Korea’ capital market
  - Field trips to financial investment business and securities-related organization

4. Investor Education ; Establishment and Role of KCIE

  - Adequate investor education to raise investor awareness regarding asset mgt. and financial investment products, etc.
  - A life-long education for the general public by offering practical curriculum to support the financial well-being of citizens.
  - Teenagers, university students, employees, housewives, the elderly and people with special vocations
- Asian Forum for Investor Education(AFIE) established by KOFIA in Feb., 2010.
- KOFIA chairs currently the International Forum for Investor Education(IFIE)
## IV. Asian SRO

### Rationale: Effectiveness

- Flexibly adjust rules and codes to meet changes in MKT practices
- Closely communicate with member institutions to make effective rules

### How to make the Asian SRO

- Should define a self-regulatory regime that is most suitable to local countries
- Consider scrupulously the relationship with regulators and domestic SROs
JS&A Self-Regulatory Activities in the Bond Market

June 30, 2011

Ryuichi Shiina, CFA
General Manager
International Affairs Division
Japan Securities Dealers Association

Agenda

I. JSDA’s Profile
II. JSDA’s Contribution to Regional Coordination among Asian SROs
III. What are SROs?

IV. General Outline of JSDA
   1. Purpose
   2. Members
   3. Organization of JSDA
   4. Securities-related SROs in Japan
   5. Self-regulatory structure for Securities Companies
I. JSDA’s Profile

• Japan Securities Dealers Association (JSDA) is an association of securities companies and financial institutions operating a securities business in Japan, established and authorized by the Financial Instruments and Exchange Act. Its major tasks are:
  ✓ as an SRO, to provide self-regulation in the Japanese securities market, and
  ✓ as a trade association, to conduct various activities to invigorate and further develop the market.

=> Due to the dual aspect of its activities, JSDA is called a “Hybrid SRO”

V. Self-regulatory activities of JSDA
1. Major self-regulatory activities
2. Activities as a Self-regulatory Organization
3. Decision-making bodies in the Self Regulation Headquarters, etc.
4. Self-regulatory rules (Major ones)
5. Registration of Sales Representatives
6. Inspection
7. Disciplinary actions imposed on Association Members and their officers and employees

VI. Others
Dispute resolution by FINMAC

VII. JSDA’s Activities Specific to Bond Market
1. Collection and Compilation of Data Base
2. Self-Regulation in the Bond Market
3. Initiative for Market Expansion
II. JSDA’s Contribution to Regional Coordination among Asian SROs

- JSDA initiated the “Asia Securities Forum (ASF)” in 1995 to promote regional coordination among Asian and Pacific SROs.
- JSDA has been providing the members of ASF and other Asian regulators, SROs and trade associations with a training opportunity for upgrading the self-regulatory expertise of their staff by inviting them every year to Tokyo since 2006. (Last year, 16 countries including Turkey and UAE participated). => “ASF Tokyo Round Table”

ASF’s Current Members
The members comprise mainly representatives of securities dealers associations or securities companies in the Asia-Pacific region. (Countries in red color coincide with ABMF members)

<table>
<thead>
<tr>
<th>Country</th>
<th>Member</th>
</tr>
</thead>
<tbody>
<tr>
<td>Australia</td>
<td>Australian Financial Markets Association (AFMA)</td>
</tr>
<tr>
<td>China</td>
<td>Securities Association of China (SAC)</td>
</tr>
<tr>
<td>Chinese Taipei</td>
<td>Chinese Taiwan Securities Association (TSA)</td>
</tr>
<tr>
<td>Hong Kong</td>
<td>Hong Kong Securities Association (HKSA)</td>
</tr>
<tr>
<td>India</td>
<td>Association of National Exchanges Members of India (ANMI)</td>
</tr>
<tr>
<td>Indonesia</td>
<td>Association of Indonesian Securities Companies (APEI)</td>
</tr>
<tr>
<td>Japan</td>
<td>Japan Securities Dealers Association (JSDA)</td>
</tr>
<tr>
<td>Korea</td>
<td>Korea Financial Investment Association (KOFIA)</td>
</tr>
<tr>
<td>Malaysia</td>
<td>The Association of Stockbroking Companies Malaysia (ASCM)</td>
</tr>
<tr>
<td>New Zealand</td>
<td>New Zealand Financial Markets Association Inc. (NZFMA)</td>
</tr>
<tr>
<td>Philippines</td>
<td>Philippine Association of Securities Brokers &amp; Dealers, Inc. (PASBDI)</td>
</tr>
<tr>
<td>Thailand</td>
<td>Association of Securities Companies (ASCO)</td>
</tr>
<tr>
<td>Turkey</td>
<td>The Association of Capital Market Intermediary Institutions of Turkey (TSPAKB)</td>
</tr>
</tbody>
</table>
What are SROs?

Cf. Type of SROs

1. Exchange SROs
Securities exchanges with self-regulatory responsibilities.

2. Member or Exchange SROs
SROs based in membership of securities dealers, brokers or other intermediaries that are independent of market operators. In some cases, the organization may also function as an industry association for its members or play a role in organizing an OTC market such as a bond market.

3. Industry or dealers’ associations
Some industry associations have limited self-regulatory functions that include setting rules or obligatory standards. Others are not formal SROs, but provide guidance, best practices, or set other standards for members.

4. Central securities depositories (CSDs) and clearing agencies
CSDs and central counterparties often have limited self-regulatory functions.

Cf. Models of Self-Regulation

1. Government (Statutory) Model
A public authority is responsible for securities regulations. Exchanges are usually responsible for very limited supervision of their markets but are not considered to be SROs.

2. Limited Exchange SRO Model
A public authority is the primary regulator. It relies on exchanges to perform certain regulatory function of the market. (e.g. market surveillance and listing)

3. Strong Exchange SRO Model
A public authority is the primary regulator. It relies on exchanges to perform extensive regulatory functions.

4. Independent Member SRO Model
A public authority is the primary regulator. It relies extensively on an independent SRO (a member organization that is not a market operator) to perform extensive regulatory functions.

Industry Association SRO Model is a less developed version of this model.

Cf. UK experience

Model 1 Pure self-regulation, in which market participants draw up the rules and police them with no statutory backing or government involvement in the process.

Model 2 Self-regulatory organizations which are largely responsible for their own regimes, but where there is a process of statutory recognition of their rules as standards and codes for the sector as a whole, and therefore statutory backup for enforcement.

Model 3 Self-regulation which sits on top of a statutory regime, perhaps adding additional standards of ethical behavior and customer service to the requirements of statutory regulation.

Model 4 Practitioner involvement in the development of statutory regimes, whether through consultation or some formal locus in the process.

(Source) Howard Davies and David Green (2008), "Global Financial Regulation The essential guide" pp.211-212
True or False?: SROs start to appear along with the development of securities markets as shown below.

<table>
<thead>
<tr>
<th>Infancy of the market/ Appearance of market players</th>
<th>Appearance of regulator and industry association</th>
<th>Development of the market</th>
<th>Matured stage of the market</th>
</tr>
</thead>
<tbody>
<tr>
<td>Government Regulator 2</td>
<td>Government Regulator 1</td>
<td>SRO + Industry Association</td>
<td>Powerful SRO</td>
</tr>
<tr>
<td>Government Driven</td>
<td>Transfer of a part of its regulatory functions</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Industry Driven</td>
<td>Market Players</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Industry Association</td>
<td>SRO + Industry Association</td>
<td></td>
<td></td>
</tr>
<tr>
<td>SRO</td>
<td>Powerful SRO</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

cf. Case of US FINRA + SIFMA

Classification of 17 Participants’ Organizations to the latest ASF training seminar (in 2010)

- **Financial Regulator**
  - FSA (Kazakhstan): 490
  - FRC (Mongolia): 90
  - SEC (Sri Lanka): 70
  - DFSA (UAE): 120
  - CSM (Uzbekistan): 110

- **SROs not existing in those countries**

- **Hybrid Type**
  - SAC (China): 85
  - JSDDA (Japan): 258
  - KOFIA (Korea): 255
  - CTSA (Taiwan): 50
  - TBMA (Thailand): 42
  - TSPARB (Turkey): 18

- **Industrial Association**
  - HKSA (Hong Kong): 5
  - ANMI (India): 15
  - APEI (Indonesia): 5
  - ASCM (Malaysia): 3

- **SROs not existing in those countries**

Several other Asian countries have industrial association such as Philippine, Singapore, Thailand, etc.
IV. General Outline of JSDA

1. Purposes
   • Promotion of fairness and smoothness in the sale and purchase or other transactions of securities and derivatives transactions, etc.
   • Ensuring sound development of financial instruments business
   • Protection of investors

2. Members

<table>
<thead>
<tr>
<th>Type</th>
<th>Description</th>
<th>Number</th>
</tr>
</thead>
<tbody>
<tr>
<td>Regular Members</td>
<td>Securities companies (including foreign securities companies)</td>
<td>292</td>
</tr>
<tr>
<td>Special Members</td>
<td>Banks, insurance companies, and other financial institutions</td>
<td>218</td>
</tr>
</tbody>
</table>

(Note) As of April 1st 2011
4. Securities-related SROs in Japan

- **FSA**
- **Exchanges**
  - Member and Market Regulation SRO
- **JSDA**
  - Member and Market Regulation SRO
- **Investment Trusts Association**
  - Member Regulation SRO
- **Financial Futures Association of Japan**
  - Member Regulation SRO
- **Japan Securities Investment Advisers Association**
  - Member Regulation SRO

- Trading participant
- Listed companies
- All securities companies
- Registered financial institutions
- Investment trust companies
- Investment trust distributors
- Financial futures broker dealer
- Investment advisers

5. Self-Regulatory Structure for Securities Companies

- **FSA**
- **SESC**

**SROs**

- **JSDA**
  - Stock Exchanges
- **Self-regulatory rules**
  - Inspection of Compliance with laws and Self-regulatory rules
  - Market surveillance

**Securities Companies**
V. Self-regulatory activities of JSDA

1. Major self-regulatory activities

(1) Establishment and revision of self-regulatory rules
(2) Instructions to Association Members for compliance of laws, regulations, and rules
(3) Qualification examination and obligatory training courses for officers and employees of Association Members; registration of sales representatives
(4) Inspection of Association Members
(5) Disciplinary actions against Association Members and their officers and employees

2. Activities as a Self-regulatory Organization (SRO)

Functions Stipulated in the Financial Instruments and Exchange Act

<table>
<thead>
<tr>
<th>Provisions under the Law</th>
<th>Functions</th>
<th>Outcome and Results (data in FY2009)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Rule-making (Item 10, Paragraph 1 of Article 67-8)</td>
<td>- Establishment and enforcement of Self-regulatory rules to be applied to members</td>
<td>- Self-regulatory rules</td>
</tr>
<tr>
<td>Inspection and Monitoring of members’ compliance with laws and regulations (Item 14, Paragraph 1 of Article 67-8)</td>
<td>- Inspection and monitoring of members’ business activities and internal control system</td>
<td>- Inspected 141 members (84 regular members and 57 special members)</td>
</tr>
<tr>
<td>Disciplinary Actions (Article 68-2)</td>
<td>- Reprimand, fines, suspension or limitation of membership, expulsion</td>
<td>- Fines (1 members), reprimands (4 members)</td>
</tr>
</tbody>
</table>
| Qualifications of members’ officers and employees (Item 9, Paragraph 1 of Article 67-8) | - Qualification Examination and Qualification Renewal Training            | - Number of examinees: 197,519
                                                                      |                                                                            | - Number of training course participants: 58,719 |
| Settlements of complaints and mediations between investors and members (Item 11, Paragraph 1 of Article 67-8) | - Activities through Securities Mediation and Consultation Centers        | - Number of mediations: 204
                                                                      |                                                                            | - Number of complaints and consultations: 5,099 |
3. Decision-making bodies in the Self Regulation Dept., etc.

(1) **Board of Governors** (10 governors)
The decision-making on self-regulatory activities is basically commissioned to Self Regulation Board.

(2) **Self Regulation Board**
A decision-making body on self-regulatory activities

<table>
<thead>
<tr>
<th>Self Regulation Board (13 board members)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Non-Association Member: 7</td>
</tr>
<tr>
<td>Chair (Public governor): 1</td>
</tr>
<tr>
<td>Public Members: 4</td>
</tr>
<tr>
<td>Chairman (Standing governor): 1</td>
</tr>
<tr>
<td>Vice-chairman (Standing governor): 1</td>
</tr>
</tbody>
</table>

(3) **Committees under Self Regulation Board**

- Committees that discuss about proposed self-regulatory regulations and an audit plan in every year

<table>
<thead>
<tr>
<th>Self regulatory Planning Committee</th>
</tr>
</thead>
<tbody>
<tr>
<td>Equity Committee</td>
</tr>
<tr>
<td>Bonds Committee</td>
</tr>
<tr>
<td>Financial Instruments Committee</td>
</tr>
<tr>
<td>Consisting of officers and employees of the Association Members</td>
</tr>
</tbody>
</table>

- Committees that discuss about proposed disciplinary actions against Association Members and their officers and employees

<table>
<thead>
<tr>
<th>Disciplinary Committee</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sales Representative Disciplinary Committee</td>
</tr>
<tr>
<td>Consisting of public members and officers and employees of the Association Members</td>
</tr>
</tbody>
</table>
(4) **Auxiliary bodies for self-regulatory activities**

- Committee that has an authorization to conduct the qualification examination for sales representatives

<table>
<thead>
<tr>
<th>Sales Representative Examination Committee</th>
<th>Consisting of public members and officers and employees of the Association Members</th>
</tr>
</thead>
</table>

- Persons who are authorized to conduct investigation and confirmation stipulated in Article 119, Section 1, Item 9 (ii) of the Cabinet Office Ordinance Concerning Financial Instruments Business, etc.

<table>
<thead>
<tr>
<th>Problematic Conduct Confirmation Committee (Note)</th>
<th>The number of Attorney-at-laws: Three (as of May 2011)</th>
</tr>
</thead>
</table>

Note: The "Problematic Conduct Confirmation Committee" is an organization that conducts the pre-confirmation process (examination) for compensation for losses incurred by customers due to an administrative error by the Association Member. As the confirmation process is conducted by the Problematic Conduct Confirmation Committee, prior confirmation of the fact with the competent authority is unnecessary when deciding whether the compensation should be made for losses incurred by customers due to an administrative error by the Association Member, enabling a quick resolution of the issue. However, in the case where the compensation amount is larger than 10 million yen, prior confirmation with the competent authority is still necessary. On the other hand, if the amount is 100,000 yen or smaller, the pre-confirmation process is not required and the concerned Association Member may report the problematic conduct to the competent authority after resolving the issue.

- Organization that examines filing of complaint for dispositions made to the Association Members

<table>
<thead>
<tr>
<th>Complaints Examination Committee (Note)</th>
<th>The number of Attorney-at-laws: Three (as of May 2011)</th>
</tr>
</thead>
</table>
4. Self-regulatory rules (major ones)

(1) Advertisement, investment solicitation, and internal control system

- Regulations Concerning Solicitation for Investments and Management of Customers, etc. by Association Members
  - Obligations in investment solicitation and customer management

- Regulations Concerning Representation of Advertising, etc. and Offer of Premiums
  - Points to be checked on the representation of advertising
  - Obligation to review advertisements

- Regulations Concerning Establishing a Sale and Purchase Management System for the Prevention of Unfair Trading
  - Review of sale and purchase of listed share certificates

- Regulations Concerning Sale and Purchase, etc. of Specified Securities, etc. of Listed Companies, etc. by Employees of Association Members
  - Establishment of management system to check sale and purchase, etc. of securities by employees of Association Members

(2) Contractual relationship with customers

- Regulations Concerning Acceptance, etc. of Deposit of Securities
  - Executing a contract with customers when securities are deposited by the customers

(3) Employees, sales representatives, internal administrators

- Regulations Concerning Employees of Association Members
  - Standards of duties and prohibited actions for employees of Association Members
  - Inquiry to the Association at the time of hiring of employees
  - Reporting to the Association at the time of breach of laws and regulations by employees, and disciplinary actions by Association

- Regulations Concerning Maintenance of and Compliance with Ethical Code by Association Members
  - Each Association Member should establish the Code of Ethics based on the JSDA model.
Regulations Concerning Sale and Purchase, etc. of Specified Securities, etc.
of Listed Companies, etc. by Employees of Association Members
- Establishment of management system of sale and purchase, etc. of securities
  by employees of Association Members

Regulations Concerning Qualification and Registration, etc. of Sales
Representatives of Association Members
- Qualification requirements and obligation for training for sales representatives
  (persons who conduct securities business)
- Administration pertaining to the registration of sales representatives

Regulations Concerning Internal Administrators, etc. of Association Members
- Qualification, allocation, and responsibilities of person who is responsible for
  compliance
- Internal Administration Supervisor, Internal Administration Assistant Supervisor,
  Sales Manager, Internal Administrator

Regulations focusing on financial instruments and business

Regulations Concerning Over-The-Counter Securities
- Prohibition in principle of investment solicitation of securities not listed in
  exchanges

Regulations Concerning Underwriting, etc. of Securities
- Establishment of systems for underwriting business
- Implementation of underwriting examination
- Underwriting examination items

Regulations Concerning Publication of Over-The-Counter Trading
Reference Prices, etc., of Bonds and Trading Prices
- Ensuring fairness in transaction of public and corporate bonds
- Calculation and publication of trading reference price and of bonds by the
  Association

Regulations Concerning Foreign Securities Transactions
- Executing an “Agreement Concerning Foreign Securities Transaction
  Account” with customers when the Association Members make a
  transaction of foreign securities with customers

Regulations Concerning Distributions, etc. of Securitized Products
- Ensuring traceability of securitized products

Regulations Concerning CFD Transactions
- Regulations concerning solicitation of securities CFD transactions and
  establishment of a system for loss-cut transactions
(5) Disciplinary actions against Association Members

- Articles of Association
  - Reasons for disciplinary actions, type of disciplinary actions against Association Members

(6) Resolution of disputes and mediation

- Regulations concerning business entrustment etc. for resolution of disputes, etc. between Association Member and customer

5. Registration of Sales Representatives

Implementation of qualification examination and obligatory training courses for officers and employees of the Association Members

(1) Registration of sales representatives

- Where a financial instruments business operator has its employee conduct securities business, it shall register the name and date of birth, etc. of such employee to “The Registry of Sales Representatives” (Article 64 of the Financial Instruments and Exchange Act).

- “The Registry of Sales Representatives” of the Association Members shall be managed by the Association (Article 64-7 of the Financial Instruments and Exchange Act).
(2) Qualification examination of sales representatives

- Examinations that give the required qualification for the registration of sales representative to officers and employees of the Association Members

  - Regular Members (Securities companies)
    - Qualification Examination for the Class-1 Sales Representative (All the businesses)
    - Qualification Examination for the Class-2 Sales Representative (Businesses other than derivative transactions)

  - Special Members
    - Qualification Examination for the Special Member’s Class-1 Sales Representative (Businesses other than equity business)
    - Qualification Examination for the Special Member’s Class-2 Sales Representative (Businesses other than equity business and derivative business)
    - Qualification Examination for the Special Member’s Class-4 Sales Representative (Investment trust business and business relating to specified OTC derivative transactions)

(Note) Class II Sales Representative Examination is open to the public in addition to officers and employees of the Association Members.

- Computer-based examination

The data of persons who passed the examination (qualified persons) such as name is managed by computer systems at the Association.

- Details of Class-1 Sales Representative Examination

  - Testing hours: Two hours
  - Number of questions: 76 questions (pass score: 70% or more of correct answers)
  - Tested subjects:
    - Financial Instruments and Exchange Act, Investment Trust Act, JSDA rules and regulations, exchange rules and regulations
    - Equities, bonds, investment trusts, futures, options, specified OTC derivative transactions, etc.
    - Corporate Act; common knowledge on economic, monetary, and financial issues; financial statements and corporate analysis; taxation; sales operations
(3) Qualification examination for Internal Administrators

- Examinations to give necessary qualification to officers and employees of the Association when they take an office of Internal Administration Assistant Supervisor, Sales Manager, or Internal Administrator

<table>
<thead>
<tr>
<th>Regular Members (securities companies)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Examination of Regular Member Internal Administrator Qualification</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Special Members</th>
</tr>
</thead>
<tbody>
<tr>
<td>Examination of Special Member Internal Administrator Qualification</td>
</tr>
</tbody>
</table>

- Computer-based training
- The data of persons who passed the examination (qualified persons) such as name is managed by computer systems at the Association.

(4) Implementation of Obligatory Training Courses

- Training courses for renewal of sales representative qualification
  - Sales representatives need to participate in the training courses provided by the Association in every five years. If he/she fails to participate in the training course, his/her qualification is revoked.
  - Computer-based training (two hours)

- Training courses for internal administration supervisors
  - The Association holds a one-day class seminar.
6. Inspection

(1) Inspection of Regular Members

<table>
<thead>
<tr>
<th></th>
<th>FY 2007</th>
<th>FY 2008</th>
<th>FY 2009</th>
<th>FY 2010</th>
</tr>
</thead>
<tbody>
<tr>
<td>The number of Regular Members inspected</td>
<td>108 companies</td>
<td>91 companies</td>
<td>91 companies</td>
<td>84 companies</td>
</tr>
<tr>
<td>Averaged number of days spent for inspection per company</td>
<td>6.0 days</td>
<td>6.0 days</td>
<td>6.1 days</td>
<td>6.3 days</td>
</tr>
<tr>
<td>Averaged number of inspectors per company</td>
<td>4.8 persons</td>
<td>4.9 persons</td>
<td>4.6 persons</td>
<td>4.5 persons</td>
</tr>
<tr>
<td>Number of inspected companies that have reported findings</td>
<td>51 companies</td>
<td>55 companies</td>
<td>43 companies</td>
<td>28 Companies</td>
</tr>
</tbody>
</table>

(2) Inspection of Special Members

<table>
<thead>
<tr>
<th></th>
<th>FY 2007</th>
<th>FY 2008</th>
<th>FY 2009</th>
<th>FY 2010</th>
</tr>
</thead>
<tbody>
<tr>
<td>The number of Special Members inspected</td>
<td>69 companies</td>
<td>61 companies</td>
<td>61 companies</td>
<td>57 companies</td>
</tr>
<tr>
<td>Averaged number of days spent for inspection per company</td>
<td>4.8 days</td>
<td>5.2 days</td>
<td>5.2 days</td>
<td>4.9 days</td>
</tr>
<tr>
<td>Averaged number of inspectors per company</td>
<td>3.8 persons</td>
<td>4.1 persons</td>
<td>4.0 persons</td>
<td>4.1 persons</td>
</tr>
<tr>
<td>Number of inspected companies that have reported findings</td>
<td>21 companies</td>
<td>6 companies</td>
<td>7 companies</td>
<td>17 Companies</td>
</tr>
</tbody>
</table>

7. Disciplinary actions imposed on Association Members and their officers and employees

(1) Disciplinary actions imposed on Association Members

- Type of disciplinary actions
  - 1. Disciplinary actions
    - Expulsion
    - Suspension or limitation of membership for six months or less
    - Imposition of fines of up to 500 million yen (in the case an improper gain is generated, the amount of such improper gain can be added.)
    - Reprimand
  - 2. Admonition

  Regulatory ground
  - Articles of Association
(2) Disciplinary actions imposed on employees

Type of disciplinary actions imposed on sales representatives under the Financial Instruments and Exchange Act

<p>| | |</p>
<table>
<thead>
<tr>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>1.</td>
<td>Revocation of sales representative registration</td>
</tr>
<tr>
<td>2.</td>
<td>Suspension of qualification of sales representative for two years or less</td>
</tr>
</tbody>
</table>

Regulatory grounds

- Article 64-5 of the Financial Instruments and Exchange Act
- The Association is commissioned to implement these tasks by the prime minister

Type of disciplinary actions, etc. under the regulations of the Association

<p>| | |</p>
<table>
<thead>
<tr>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>1.</td>
<td>Disciplinary Action for Perpetrators of Inappropriate Acts*</td>
</tr>
<tr>
<td>2.</td>
<td>Revocation of sales representative qualification</td>
</tr>
<tr>
<td>3.</td>
<td>Suspension of qualification of sales representative for two years or less</td>
</tr>
<tr>
<td>4.</td>
<td>Revocation of qualification of internal administration supervisor and sales manager</td>
</tr>
<tr>
<td>5.</td>
<td>Suspension of qualification of internal administration supervisor and sales manager for two years or less</td>
</tr>
</tbody>
</table>

Regulatory grounds

- Regulations Concerning Employees of Association Members
- Regulations Concerning Qualification and Registration, etc., of Sales Representatives of Association Members
- Regulations Concerning Internal Administrators, etc. of Association Members

*The system classifies the perpetrators of inappropriate act into two categories: first-degree perpetrator (prohibition of employment indefinitely) and second-degree perpetrator (prohibition of employment for five years).
VI. Others

Dispute resolution by the Financial Instruments Mediation Assistance Center (FINMAC)

- FINMAC is in charge of:
  (i) Receiving inquiries and complaints from customers regarding solicitation of financial instruments transaction and financial instruments transaction systems;

  (ii) "Mediation" for dispute resolution on financial instruments transaction between Association Member and their respective customer;

  FINMAC resolves disputes of:
  customers filing complaints and request for mediation regarding the business conducted by financial instruments business operators, etc. from a fair and neutral viewpoint, in an expeditious and transparent manner.

The following five organizations entrust consultation, complaint filing, and mediation for dispute resolution to FINMAC. FINMAC does not provide such services for business conducted by non-member firms.

(1) Japan Securities Dealers Association
(2) The Investment Trusts Association of Japan
(3) Japan Securities Investment Advisers Association
(4) The Financial Futures Association of Japan
(5) Japan Commodities Fund Association

- FINMAC also provides consultation, files complaint, and conducts mediation for dispute solution for business conducted by Type-II Financial Instruments Business Operators (business operators dealing in public offerings of various investment funds) that are registered as users of FINMAC.
VII. JSDA’s Activities Specific to Bond Market

1. Collection and Compilation of Data Base

### Issuance of Bonds

<table>
<thead>
<tr>
<th>Year</th>
<th>Non-resident</th>
<th>Bank Debenture</th>
<th>Corporate</th>
<th>Other Public</th>
<th>JGB</th>
</tr>
</thead>
<tbody>
<tr>
<td>FY1990</td>
<td>18.3</td>
<td>58.8</td>
<td>100.1</td>
<td>101.8</td>
<td>96.4</td>
</tr>
<tr>
<td>FY2000</td>
<td>36.8</td>
<td>112.4</td>
<td>21.0</td>
<td>32.9</td>
<td></td>
</tr>
<tr>
<td>FY2005</td>
<td>41.9</td>
<td>22.8</td>
<td>21.0</td>
<td>32.9</td>
<td></td>
</tr>
<tr>
<td>FY2006</td>
<td>41.9</td>
<td>36.8</td>
<td>22.8</td>
<td>32.9</td>
<td></td>
</tr>
<tr>
<td>FY2007</td>
<td>36.8</td>
<td>22.8</td>
<td>21.0</td>
<td>32.9</td>
<td></td>
</tr>
<tr>
<td>FY2008</td>
<td>22.8</td>
<td>21.0</td>
<td>32.9</td>
<td>32.9</td>
<td></td>
</tr>
<tr>
<td>FY2009</td>
<td>21.0</td>
<td>32.9</td>
<td>32.9</td>
<td>32.9</td>
<td></td>
</tr>
</tbody>
</table>

### Outstanding Bonds

- Non-resident
- Corporate etc
- Bank Debenture
- Other Public
- TB
- JGB

<table>
<thead>
<tr>
<th>Year</th>
<th>Non-resident</th>
<th>Corporate</th>
<th>Bank Debenture</th>
<th>Other Public</th>
<th>JGB</th>
</tr>
</thead>
<tbody>
<tr>
<td>FY1990</td>
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<td>58.8</td>
<td>100.1</td>
<td>101.8</td>
<td>96.4</td>
</tr>
<tr>
<td>FY2000</td>
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<td>112.4</td>
<td>21.0</td>
<td>32.9</td>
<td></td>
</tr>
<tr>
<td>FY2005</td>
<td>41.9</td>
<td>22.8</td>
<td>21.0</td>
<td>32.9</td>
<td></td>
</tr>
<tr>
<td>FY2006</td>
<td>41.9</td>
<td>36.8</td>
<td>22.8</td>
<td>32.9</td>
<td></td>
</tr>
<tr>
<td>FY2007</td>
<td>36.8</td>
<td>22.8</td>
<td>21.0</td>
<td>32.9</td>
<td></td>
</tr>
<tr>
<td>FY2008</td>
<td>22.8</td>
<td>21.0</td>
<td>32.9</td>
<td>32.9</td>
<td></td>
</tr>
<tr>
<td>FY2009</td>
<td>21.0</td>
<td>32.9</td>
<td>32.9</td>
<td>32.9</td>
<td></td>
</tr>
</tbody>
</table>
2. Self-Regulation in the Bond Market

- JSDA SRO Rules and Guidelines

(Self-Regulatory Regulations)
- Regulations Concerning Publication of Over-the-Counter Trading Reference, etc., of Bonds and Trading Prices
- Regulations Concerning Foreign Securities Transactions
- Repurchase Agreement Transaction (Gensaki Transaction)
- Bond Loan Transaction with Cash
- Transactions of Bonds with Options
- Regulation Concerning OTC Trading of Inflation-Indexed JGB, etc...

(Uniform Practice Rules)
- Rules Regarding Solution of Fail in Bond Clearing and Settlement, etc...

(JSDA Guidelines)
- JSDA Guideline to Ensure the Fairness in OTC Transaction of Bonds
- The Japanese Government Securities Guidelines for Real Time Gross Settlement
- Book-entry Transfer Guideline for "Corporate Bonds"
- JSDA Guideline for When-Issued Transaction of Japanese Government Bonds, etc...
3. Initiative for Bond Market Expansion

- **Study Group to Vitalize the Corporate Bond Market**

  Established on July, 2009, the Study Group has worked as a forum to discuss various issues relating to the current conditions and ideas for vitalization of the Japanese corporate bond market. A wide range of market participants and experts have been involved in the discussions.

  The Study Group prepared a report, entitled “Toward Vitalize of the Corporate Bond Market. In this report, JSDA summarizes the problems currently existing in the Japanese corporate bond market and indicates concrete measures to realize a more efficient corporate bond market with higher transparency and liquidity.

- **Measures for vitalization of the corporate bond market in Japan**

  - **Review of underwriting examination by securities companies**

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

    (i) Underwriting examination scheme of securities companies,
    (ii) Roles and handling of comfort letter,
    (iii) Principles to clearly share responsibilities under the FIEA and full dissemination of them.

  - **Measures to cope with default risk**

    (i) Granting of covenants and information disclosure
    (ii) Credit risk of corporation and corporate bond management
✓ Development of infrastructure for disseminating corporate bond price information

If we want to increase the issuance volume of corporate bonds, we need to expand the secondary market for corporate bonds and ensure the liquidity of corporate bonds. For this purpose, we need to increase the transparency of the secondary market to properly disclose transaction prices and quotations.

(i) Publication of transaction price
(ii) Improvement of credibility of the Reference price*

* In Japan, JSDA manages the system of Reference Statistical Prices [Yields] for OTC Bond Transactions as part of the corporate bond price information infrastructure. Under the system, JSDA receives quotation information from securities companies and publishes the average price, median price, and highest and lowest prices for each issue.

Outline of "Reference Prices [Yields] Table for OTC Bond Transactions"
• Further enhancement of the transparency and liquidity of bond market
• Contribution to the diversity of corporate bond issuers, improvement of usability, and diversification of the asset management methods (thereby creating a market easily accessed by professional institutional investors, etc.)

○ Facilitating Japanese financial and capital markets to play a international role suitable to Japan’s economic scale in the global market.
○ Enabling foreign firms and investors including those from Asian region to enter actively into our market.

Contact Information:


Ryuichi Shiina, General Manager of International Affairs Division
r_shiina@wan.jsda.or.jp
I. What is MOC

1. Market Oversight Division in KRX

BOD's Committee  Market Oversight Commission

Chairman & CEO

Management Strategy Division  Stock Market Division  KOSDAQ Market Division  Derivatives Market Division  Market Oversight Division
I. What is MOC

2. Organization of MOC

Legal Status

- Self regulatory unit within the KRX established according to the Capital Market and Financial Investment Business Act for self-regulation in the securities and derivatives markets

Independence of MOC

- The KRX guarantees the independence of MOC
- The MOC is made up of external independent members
II. Regulatory framework

1. Regulatory System

- **Statutory Regulation**
  - FSC/SFC
  - FSS

- **Self-Regulation**
  - KRX
  - KOFIA

**Capital Market**

**Financial Investment Business Entity’s Internal Control System**

<table>
<thead>
<tr>
<th>FSC: Financial Services Commission</th>
<th>FSS: Financial Supervisory Service</th>
</tr>
</thead>
<tbody>
<tr>
<td>SFC: Securities and Futures Commission</td>
<td>KOFIA: Korea Financial Investment Association</td>
</tr>
</tbody>
</table>

II. Regulatory framework

2. Statutory (Government) Regulation

- **FSC (Financial Services Commission)**
  - Approval of incorporation of financial institutions
  - Supervision over financial institutions and related organizations
  - Establishment and amendment of regulations on financial institutions
  - Direction over FSS
  - Administrative sanctions on regulated organizations

- **SFC (Securities & Futures Commission)**
  - Investigation on unfair trading
  - Supervision over securities and futures market (delegated from FSC)

- **FSS (Financial Supervisory Service)**
  - Examination and supervision over business and financial status of financial institutions (delegated from FSC & SFC)
  - Business assistance for FSC and SFC
  - Dispute resolution between financial institutions and investors
II. Regulatory framework

3. Self Regulation

**KRX (Korea Exchange)**
- Operation of securities and derivatives market
- Listing and corporate disclosure
- Market surveillance and member examination
- Enforcement on members
- Dispute resolution on trades within the market

**KOFIA (Korea Financial Investment Association)**
- Maintenance of sound and orderly sales practice of members
- Examination on members (delegated from FSS)
- Dispute resolution regarding business conduct of members

---

**II. Regulatory framework**

3. Self Regulation

**Concept of Self-regulatory regime**

- The market participants establish the regulatory rules (voluntary regulation) by mutual consent, in order to achieve the market integrity
  ⇒ Means of private self-policing (early stage)

- The self-regulation has been endorsed by the law, because of its growing importance
  ⇒ Delegated by the law (of late)
II. Regulatory framework

3. Self Regulation

**Advantages of Self-regulation**

- **Flexibility**
  - Timely amendment and enforcement, responding to the changing situations

- **Market-friendliness**
  - Determined by the consensus of market participants

- **Economic Efficiency**
  - Minimizing the burden of public funding by voluntary observation

- **Regulatory Effectiveness**
  - Information and market expertise are readily available

---

III. Operations

1. Work flow

   **Preliminary Investigation**

   **Detection of Abnormal Trading**

   **Investigation or Member Firm Examination**

   - Target: Listed(Stock) Companies
   - Pre-Arranged trade, Wash sale, Fictitious order or quote

   - Requesting for Reference disclosure
   - Requesting for Preventative Measures
   - Investigation warning

   - Target: Stock, DR, Index fund

   - Referral to FSC
   - Disciplinary action
### III. Operations

#### 1. Work flow

**A**

Detection of Abnormal Trading
- The price of an issue exceeds the upper price limit applied by regression model, etc.

<table>
<thead>
<tr>
<th>Name of Issue</th>
<th>Criteria for detection</th>
<th>Present Price</th>
<th>Price Change Rate (D-5, D-20)</th>
<th>Trading Volume (accu)</th>
<th>News &amp; Rumors</th>
<th>Inquiry of Disclosing</th>
</tr>
</thead>
<tbody>
<tr>
<td>A</td>
<td>ABCDCEFJJK</td>
<td>3,100</td>
<td>3.22 11.40</td>
<td>36,000</td>
<td></td>
<td></td>
</tr>
<tr>
<td>B</td>
<td>1</td>
<td>4,200</td>
<td>10.22 1.82</td>
<td>1,251</td>
<td></td>
<td></td>
</tr>
<tr>
<td>C</td>
<td>1</td>
<td>3,500</td>
<td>-4.51 12.30</td>
<td>121,000</td>
<td></td>
<td></td>
</tr>
<tr>
<td>D</td>
<td>1</td>
<td>12,500</td>
<td>75.0 230.00</td>
<td>3,700,000</td>
<td>2</td>
<td></td>
</tr>
</tbody>
</table>

**Korea Exchange**

### III. Operations

#### 1. Work flow

**B**

Requesting for Preventative Measures
- To prevent the additional suspicious trades or order by asking member firm to take precautionary action.
- Composed of 3 sequential cautionary steps

**Step 1**
Notifying suspicious trades and asking member firm to take proper action by telephone.

**Step 2**
Notifying repeated trades and asking member firm to take action by official document.

**Step 3**
Entrusting the issue to Examination dept

**Korea Exchange**
III. Operations

1. Work flow

**Requesting for preventative Measures**

**Name of securities : SS**

<table>
<thead>
<tr>
<th>Member</th>
<th>Branch</th>
<th>Volume</th>
<th>Frequency</th>
<th>Cancellation</th>
<th>Frequency</th>
</tr>
</thead>
<tbody>
<tr>
<td>A</td>
<td>1</td>
<td>1,000</td>
<td>41</td>
<td>900</td>
<td>40</td>
</tr>
<tr>
<td>Sum</td>
<td></td>
<td></td>
<td></td>
<td>900</td>
<td>40</td>
</tr>
</tbody>
</table>

**Cancellation of quotes :** Any member or branch which exceeds any cancellation level based on daily trading volume is designed for detection.

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III. Operations

1. Work flow

**Investment Warning**

- To promote awareness to the risk of market abuses and prevent investor's irrational trading.

Designating issues step by step according to the probability of unfair trading or speculative demands.

**Step 1** Alert  **Step 2** Caution  **Step 3** Risk
III. Operations

1. Work flow

**Procedure of preliminary surveillance**
- Detected not always mean illegal trades (possible)

**Step 1**
Looking into detailed characteristics of the issue:
news, rumors, disclosures etc

**Step 2**
Identifying suspicious trader (broker):
broker branch, IP (internet protocol) etc

**Step 3**
Drawing suspicions from trades or orders:
suspicious types; insider trading, manipulation

---

III. Operations

2. Investigation & Examination

<table>
<thead>
<tr>
<th>Investigation</th>
<th>Examination</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Parties regulated</strong></td>
<td>Members securities firms of KRX</td>
</tr>
<tr>
<td>Market Participants (unspecified, any and every person)</td>
<td>Violation of the KRX's rules and regulations relating to securities transaction</td>
</tr>
<tr>
<td>Unfair trading activities stipulated by FISCMA</td>
<td>Both on-site and documentary method</td>
</tr>
<tr>
<td>Usually use documentary method</td>
<td>Take disciplinary measures to Member directly</td>
</tr>
<tr>
<td>Transfer to FSS(FSC)</td>
<td></td>
</tr>
</tbody>
</table>

---
III. Operations

3. Support of member’s In-house Monitoring

Member firms directly interact with their customers, and are in the best position to identify abnormal or unfair trades and block them in advance.

Therefore, the Committee has supported the member firms in the development and establishment of “In-house Unfair Trading Monitoring system”, which makes possible identification of customers who carry out flawed trades, and enables the firms to take appropriate measures against such trading activities.

**Steps for Monitoring Abnormal Trading Activities**

1. **Warning by telephone**
   - Additional detection within 3 months from Step 3: refusal of further entrustment of trading for more than 5 business days

2. **Warning by document**
   - Additional detection within 1 year from refusal to entrustment: refusal of entrustment for more than 3 months

3. **Warning of refusal of further entrustment of trading**
   - Adjust the first step after no detection for 3 months from the previous warning

**Types of activities monitored**

- Fictitious orders
- Matched/washed sales
- Indiscreet interference in determination of the estimated closing/opening price
- Excessive participation in closing price determination
- Trading of non-liquid preferred shares
- Segmented order
- Trading of non-deposited securities

- Excessive participation in closing price determination
- Matched/washed sales
- Reported matters relating to program trading
### III. Operations

#### 3. Support of member’s In-house Monitoring

**In-house monitoring system check**

- Comparing member’s system with KRX’s system
- Taking disciplinary actions in case that appropriate warning were not taken considering intimacy with customer and business showings although member firm would have known about unsound orders
- Taking a severe disciplinary actions, in case that officers and employees of member firm is engaged in unsound order

### IV. Market Surveillance System

- The KRX MOC operates the cutting-edge Market Surveillance System that supports the early and accurate detection and investigation of unfair trading activities.

- The system monitors the trading activities in securities and derivatives markets and makes an automatic analysis of trading patterns, and the capability of the system is known internationally.
IV. Market Surveillance System

Market Oversight
- Analysis of Order Transaction
- Detection of Abnormal Trading
- Demand for Preventive Measures

Announcement

Investigation
- Analysis of Linkage
- Analysis of Account Info
- Analysis of Clients

On-Demand Inspection
- Periodic Inspection
- Detection of Abnormal activities

Member Inspection
- Surveillance of Program Trading
- Surveillance of Inter-Market Linkage

V. Global activities

As Cross-border trading such as cross-listing and trading linkages with foreign capital market becomes common, the international regulatory cooperation against unfair trading practices is becoming more critical.

To actively respond to the changing environment, KRX willingly participates in the international cooperative system for prevention of unfair trading and strengthens its ties with the supervisory and/or other countries.

ISG (Inter-market Surveillance Group)

The ISG is an entity created and operated under the ISG Agreement, an agreement among the many self-regulatory organizations in the world, with the purpose of exchanging information on market surveillance and international cooperation on the enforcement matters.

KRX MOC signed the ISG Agreement in July 2007, thus being prepared to deal with cross-border unfair trading.
V. Global activities

CRO(Chief Regulatory Officer) Conference

- The conference of CROs, which the KRX initiated in October 2005, is a forum facilitating the discussions on the matters of international cooperation and common regulatory concerns among the CROs of various exchanges.

- By presenting the theme papers and making recommendations on key issues, the KRX MOC has been playing a lead role at the CRO Conference.

IOSCO SRO Committee

- IOSCO SRO Committee is a consultative committee of the IOSCO, which has been established to support the cooperation among the securities regulatory agencies in the world, thus enhancing the efficiency and fairness of securities market.

- The KRX MOC not only participates in the meetings but also expresses its opinions as an active member.

IV. Vision of the MOC

To Grow into World-class Premier Market

To Reinforce The Market Competitiveness

Rapid Response to Unfair Trading and Prevention System against the Recurrence

Fair, Transparent and Reliable Market in which Investors can Invest for their “Hope & Future”

Reinforcement of Preventive Actions against Unfair Trading

Innovative Service Improvement for Market Participants
감사합니다.
The Role of the Exchange in
TOKYO PRO-BOND Market

June 30, 2011
TOKYO AIM, Inc.

Implication of TOKYO PRO-BOND Market

Inukai & Hyun (2010)

Sequence of Bond Markets Development in Asia

Homogeneity

Domestic

Inter-Regional

TOKYO PRO-BOND Market

Current Japanese Market

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Expected Schedule for the Launch of the TOKYO PRO-BOND Market

**Nov 10 – Dec 9, 2010**  Announcement of the market framework. The 1st public consultation.

**Mar 2 – Mar 23, 2011**  Announcement of the detailed rules and Q&As. The 2nd public consultation.

**May 17, 2011**  Publication of the approved rules.

(**June – July, 2011**)

**Launch of the market.**

i.e. First program listing or issuance.

---

Market Structure for TOKYO PRO-BOND Market

Tokyo Stock Exchange Group, Inc.  51%

London Stock Exchange plc.  49%

TOKYO AIM, Inc.

---

Equity Market  TOKYO AIM

Bond Market  TOKYO PRO-BOND Market
There is a Dilemma between
1. protecting small retail investors, and
2. enhancing flexible international professional market.

The Japanese Government revised the Financial Instruments and Exchange Act (FIEA) in 2008, creating a new professional investor only market system in order to meet the above two needs.

The biggest feature of this legal framework is the creation of the “exchange regulated” market system.

### Features of the Professional Securities Market System -1

<table>
<thead>
<tr>
<th>Who decides disclosure format?</th>
<th>New Professional Only System</th>
<th>Existing System</th>
</tr>
</thead>
<tbody>
<tr>
<td>Who decides disclosure language?</td>
<td>Exchange</td>
<td>J-FSA</td>
</tr>
<tr>
<td>Who decides accounting standards to be used?</td>
<td>Exchange</td>
<td>J-FSA</td>
</tr>
<tr>
<td>Who operates disclosure system?</td>
<td>Exchange</td>
<td>J-FSA</td>
</tr>
<tr>
<td>Who receives the documents submitted from the issuer?</td>
<td>Exchange</td>
<td>J-FSA</td>
</tr>
</tbody>
</table>
### Features of the Professional Securities Market System -2

<table>
<thead>
<tr>
<th></th>
<th>New Professional Only System</th>
<th>Existing System</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Investors</strong></td>
<td>• Qualified institutional investors (i.e. financial institutions)</td>
<td>• All investors including small retail investors</td>
</tr>
<tr>
<td></td>
<td>• Listed companies</td>
<td></td>
</tr>
<tr>
<td></td>
<td>• Unlisted companies with over JPY 500M</td>
<td></td>
</tr>
<tr>
<td></td>
<td>• Approved specified investors</td>
<td></td>
</tr>
<tr>
<td></td>
<td>- All companies</td>
<td></td>
</tr>
<tr>
<td></td>
<td>- High-net-worth individuals with over JPY 300 M in net assets</td>
<td></td>
</tr>
<tr>
<td></td>
<td>and financial assets and with at least one year of investment</td>
<td></td>
</tr>
<tr>
<td></td>
<td>experience</td>
<td></td>
</tr>
<tr>
<td><strong>Penalty for false</strong></td>
<td>• Same as the existing system</td>
<td>• Criminal penalty,</td>
</tr>
<tr>
<td><strong>financial</strong></td>
<td></td>
<td>• Administrative penalty,</td>
</tr>
<tr>
<td><strong>statement or insider</strong></td>
<td></td>
<td>etc.</td>
</tr>
<tr>
<td><strong>trading, etc.</strong></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>


**The New Growth Strategy: June 18th, 2010**

The financial sector itself needs to grow. To support this, we will proceed with measures such as improving markets and exchanges and reforming legal infrastructure for financing, and create a financial industry which is reliable and highly convenient to users, thereby making Japan’s financial markets and financial industry more internationally competitive.

Specifically, in order to create a financial market in Japan which can compare with the Euromarket, the nation will develop a bond market for professional investors, and make arrangements (e.g. expand the scope of disclosure in English) for encouraging foreign enterprises, etc. to procure capital in Japan.


If debt capital market for professional investors is developed, such as those in the Euro MTN market under a flexible disclosure regime which reduces the issuance cost, it will provide more options for companies in fundraising.

At present, in order to promote this vision, TOKYO AIM exchange is considering creating a bond market, the TOKYO PRO-BOND Market, for professional investors to enable timely issuance of debt instruments by companies through means such as providing flexible disclosure regime.

When TOKYO AIM exchange submits an application for authorization in FY2010, the FSA will examine it appropriately to promote establishment of the new market.

Furthermore, the FSA will continuously encourage market participants to facility the development of domestic dept capital market.
### Comparison of Japanese and Euro Markets

<table>
<thead>
<tr>
<th>The Euro Bond Issue Market</th>
<th>The Japanese Bond Issue Market</th>
</tr>
</thead>
<tbody>
<tr>
<td>LSE Main Board (About 15,000 issues)</td>
<td>Securities Registration Statement System (Shelf Registration System)</td>
</tr>
<tr>
<td>LSE PSM (About 500 issues)</td>
<td>The system is for private investors</td>
</tr>
<tr>
<td>LUX Main Board (About 25,000 issues)</td>
<td>The issuance is mostly for professional investors</td>
</tr>
<tr>
<td>LUX Euro MTF (About 4,000 issues)</td>
<td></td>
</tr>
<tr>
<td>SGX (About 1,000 issues)</td>
<td></td>
</tr>
<tr>
<td>Private Placement (Unlisted)</td>
<td>Private Placement</td>
</tr>
</tbody>
</table>

---

<table>
<thead>
<tr>
<th>TOKYO PRO-BOND Market Features - 1</th>
</tr>
</thead>
</table>

<table>
<thead>
<tr>
<th>Investor Base</th>
<th>Samurai</th>
<th>Euro-Yen</th>
<th>TOKYO PRO-BOND Market</th>
</tr>
</thead>
<tbody>
<tr>
<td>Maximum penetration - city banks, regional banks, trust banks, life and non-life insurers, pension funds, other large institutional investors (as a legal framework, retail is also included)</td>
<td>Similar investor base to Samurai but maximum 49 investors per tranche (more if QII)</td>
<td>Same investor base as Samurai (as a legal framework retail is excluded)</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Language</th>
<th>Japanese</th>
<th>English</th>
<th>English and/or Japanese</th>
</tr>
</thead>
</table>

|-------------------------------|-------------------------|--------------|----------------------|

<table>
<thead>
<tr>
<th>Programme VS Stand alone</th>
<th>Stand alone documentation (Shelf registration allowed)</th>
<th>EMTN Programme</th>
<th>EMTN type programme or Stand alone documentation</th>
</tr>
</thead>
</table>
### TOKYO PRO-BOND Market Features - 2

<table>
<thead>
<tr>
<th></th>
<th>Samurai</th>
<th>Euro-Yen</th>
<th>TOKYO PRO-BOND Market</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Listed on</strong></td>
<td>Not Listed (J-FSA's disclosure system)</td>
<td>LSE, LUX, Singapore, etc</td>
<td>TOKYO PRO-BOND Market (TOKYO AIM, Inc.)</td>
</tr>
<tr>
<td><strong>Legal responsibility for underwriters</strong></td>
<td>Heavy</td>
<td>Light</td>
<td>Light</td>
</tr>
<tr>
<td><strong>Timing</strong></td>
<td>Approximately 2 months Timing from drafting to close for first time issuer</td>
<td>Short</td>
<td>Short</td>
</tr>
<tr>
<td><strong>Issuing window</strong></td>
<td>Narrow</td>
<td>Wide</td>
<td>Wide</td>
</tr>
<tr>
<td><strong>Governing Law</strong></td>
<td>Japanese Law</td>
<td>English Law, etc</td>
<td>Not Limited</td>
</tr>
</tbody>
</table>

### TOKYO PRO-BOND Market Features - 3

<table>
<thead>
<tr>
<th></th>
<th>Samurai</th>
<th>Euro-Yen</th>
<th>TOKYO PRO-BOND Market</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Ratings</strong></td>
<td>S &amp; P, Moody’s, Fitch or Japanese Rating (JCR/R&amp;I)</td>
<td>S&amp;P, Moody’s or Fitch</td>
<td>S &amp; P, Moody’s, Fitch or Japanese Rating (JCR/R&amp;I)</td>
</tr>
<tr>
<td><strong>Currency</strong></td>
<td>JPY</td>
<td>Not Limited</td>
<td>Not Limited</td>
</tr>
<tr>
<td><strong>Settlement</strong></td>
<td>JASDEC</td>
<td>Euroclear, etc</td>
<td>Not Limited</td>
</tr>
<tr>
<td><strong>Secondary Trading</strong></td>
<td>OTC</td>
<td>OTC</td>
<td>OTC</td>
</tr>
<tr>
<td><strong>Expenses</strong></td>
<td>Japanese translation’s cost is significant</td>
<td>Limited</td>
<td>Limited</td>
</tr>
</tbody>
</table>
TOKYO PRO-BOND Market Target Issuers

- Large Japanese corporations which issue bonds worldwide.
- Japanese corporations which are utilizing Euro MTN programme but targeting Japanese Investors.
- Non-Japanese large corporations and Sovereign issuers which:
  1. are currently issuing Samurai bonds.
  2. have not issued Samurai bonds.

Please contact for details to
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Phone +81-3-5847-0817
Kazuhiro Iida Email k-iida@tokyo-aim.com
Phone +81-3-5847-0819
REINVESTING ASEAN+3 SAVINGS INTO ASEAN+3 BOND MARKETS – IS THERE A COMMON DIRECTION?

4TH ABMF Meeting

Thomas Meow
Executive Vice President – Group Treasury, CIMB Investment Bank
Chairman - DCM Committee, Malaysian Investment Banking Association
(Representing Mr Lee K. Kwan, Chairman – Financial Market Association Malaysia)

Jeju Island, Korea
30th June, 2011

Vision for an ASEAN+3 Bond Markets

ASEAN+3 Excess Savings

invest in

ASEAN+3 Bonds

issued by

ASEAN+3 Issuers
Current State of Buy-Side: ASEAN+3 Excess Savings bypass Asean+3 Bond Markets to invest mostly in Eurobond Markets

- ASEAN+3 countries established rules to allow our investors to invest in Eurobond Markets
- No longer reflective of trade flows
- Weak USD & EURO contributed to the drop in the value of savings

Vision #1: ASEAN+3 Excess Savings partly invested in Asean+3 Bond Markets

- Investment in Eurobond will continue for the purpose of reserve & investment flow management
- Similar changes in rules to allow this to happen
- Changes will not affect domestic market
Next Steps to Realise Vision #1

Credit Rating:

1. New International Credit Rating Agencies (Private Sector Initiatives)
2. Mutual Recognition of Credit Rating Agencies (Requires regulatory changes)

- Proposal will not affect compulsory rating from local credit rating agencies for selling to the local investors.
- Proposal is to divert the investment from Eurodollar Markets to ASEAN+3 Bond Markets. Proposal is NOT to divert the investment in Local Markets to ASEAN+3 Bond Markets.
- If regulators allow the use of international rating agencies (S&P, Moody’s and Fitch) by ASEAN+3 investors when investing in Eurobond Markets, why can’t regulators allow the use of ratings assigned by other ASEAN+3 local credit rating agencies or a new international credit rating agencies based in ASEAN+3?
- To fully thrash out the issues and hindrances in investing into ASEAN+3 Corporate Bond Markets, ABF3 is proposed either as a new fund or as an extension of ABF2.

---

Current State of Sell-side: ASEAN+3 Issuers bypass ASEAN+3 Bond Markets to issue in Eurobond Markets

- ASEAN+3 countries established “Reg S” equivalent rules to allow issuers to issue in Eurobond Markets
- Justification that local market is too small
- With more trades moving back to intra ASEAN+3, we risk another “Asian Financial Crisis” style currency mismatches
Vision #2: Facilitate ASEAN+3 Issuers to issue in ASEAN+3 Bond Markets

- Issuers to tap local markets first, then ASEAN+3 Bond Markets, and then Eurobond Markets.
- Issuers should tap the cheapest market first, which is the local markets, and offer the same local currency bonds to ASEAN+3 investors.
- Similar “Reg S” rule to allow marketing and selling to ASEAN+3 investors investing Excess Savings.
- Changes will not affect domestic market (trade execution still in home country).
- Inflows of long-term funds (not “hot money”).

Next Step to Realise Vision #2

Introduce ASEAN+3 “Reg S”:
- Simplify filing process to allow roadshow and marketing by ASEAN+3 issuers.
- Must comply with home country regulatory requirements (e.g. local advisors are required at the initial stage).
- Using the same offering documents.

Establish ASEAN+3 MTN Program:
- Standard Document agreed among participating countries (can be initiated by Primary Market Associations in ASEAN+3).
- Multi-currencies.
- Must comply with home country regulatory requirement.
- Consistent with ADB’s Report on Harmonisation of Bond Standards in ASEAN+3.
Vision: ASEAN+3 Excess Savings Invest in ASEAN+3 Bonds Issued by ASEAN+3 Issuers

- Private Sector Initiatives
  - NICRA
  - ASEAN+3 Standard Documents

- Regulatory Changes
  - Mutual Recognition
  - ABF3
  - ASEAN+3 “Reg S”
  - ASEAN+3 MTN Program

- Political Will

Domestic Currency Bond Markets

ASEAN+3 Bond Markets

Eurobond Markets

Corporates
Banks
Sovereigns

Insurance Funds
Asset Managers
Pension Funds
Private Banks
Sovereign Wealth Funds

Banks
Mutual Funds

Thank You!
1. Background

ABS are used for multiple purposes; financing tools for financial firms and other firms, and restructuring tools.

Subprime mortgages are blamed for causing the global financial crisis, because the insolvency and excessive liquidity of subprime mortgages triggered the crisis.

Therefore, global reforms on the ABS market have been under way.

Asia needs to make concerted efforts in building a regulatory regime for ABS, and sharing each nation’s market development experience with each other, in order to make an ABS market that can maximize the benefits of ABS.

In order to build sound ABS markets, Asia needs a measure that suits the needs of Asia.
The Need for Asia’s Securitization Market

- ABS provides diverse benefits to the financial markets.
  - Enable asset holders to use their assets for diversified financing opportunities.
  - Expand investors’ opportunity to invest in securities with high credit rating.
  - Korea can introduced the ABS structure for restructuring purposes.

- By revitalizing Asia’s ABS market, Asia can facilitate the development of Asia’s financial markets.
  - Asian nations, except Korea and Japan, do not have an active ABS market.
  - Regional ABS issues are hardly seen, and Asia has no financial tools that capitalize on underlying assets.

- Facilitating cross-border securitization in the region will be important to advance Asia’s bond market.
  - Despite various efforts to develop Asia’s bond market, cross-border issues are not active in Asia.
  - As part of efforts to build a regional bond market, Asia needs to issue securities based on assets, and devise measures to channel Asia’s abundant liquidity into investments.
  - To do so, Asia needs to make joint efforts in building infrastructure necessary for a regional securitization market, and better understand each other’s market.

Suggestions for Asia’s Securitization Market

- Improve the harmonization between each nation’s different securitization systems.
  - The experience of Korea and Japan, where the ABS market is active, should be shared with other nations, and other Asian nations need to devise appropriate ABS regulations based on this.
  - A standardized securitization system for Asia should be discussed.

- Discuss how to facilitate each nation’s ABS market.
  - Each Asian nation should cooperate in developing its own ABS market.
  - Each nation should think about what is necessary to develop the ABS market, and devise a masterplan.

- Facilitate cross-border securitization transactions.
  - Efforts should be made to facilitate cross-border ABS issues, with the precondition that each nation reorganizes the market system, and builds infrastructure necessary for cross-border securitization.
  - Asian needs to build infrastructure for issuing cross-border ABS.
The US ABS Market

The US ABS market dwindled after the global financial crisis.
- In 2008, issues of structured products (MBS and ABS) plunged to $1.5017 trillion, a big drop compared to the previous year. The market showed a sign of recovery, but not yet reached the 2007 level yet.
- The outstanding amount of structured finance issues began to drop from 2008.
Europe’s ABS Market

- EU’s structured finance products market has contracted since 2009, due to the impact of the global financial crisis.
  - The size of issues increased until 2008, but dropped in 2009 and 2010.
  - Accordingly, the outstanding amount of structured finance products began to decline from 2010.

Asia’s ABS Market

- Asia’s securitization market development
  - In 1996, Japan built a legal foundation for ABS, and Korea, Malaysia, Philippines, Thailand, and other Asian nations followed suit.
  - Korea and Japan have a strong drive for facilitating the ABS market.
    - In Korea and Japan, ABS are issued based on diversified underlying assets.
    - Korea is actively engaged in cross-border ABS issues.
  - Singapore has a developed ABS market, that centers on CMBS, but the size of issues plunged after 2008.
  - China and Taiwan are at the early stage of establishing the ABS market.
Asia’s ABS Market

### Institutional foundation

<table>
<thead>
<tr>
<th>Country</th>
<th>Year of Enactment or Proclamation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Hong Kong, China</td>
<td>Permissive legal framework, except for conflicts with bankruptcy laws arising in certain future flow transactions</td>
</tr>
<tr>
<td>Indonesia</td>
<td>Pre-1997 securitization decrees 2002–03 securities regulator guidelines</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Country</th>
<th>Year of Enactment or Proclamation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Malaysia</td>
<td>Generally permissive common law legal framework, except for future flow transactions Well-established legal framework for Islamic securitized issues</td>
</tr>
<tr>
<td>Philippines</td>
<td>2002 Special Purpose Vehicle (SPV) Act, Republic Act No. 9182, enacted 2003 2004 Securitization Act, Republic Act No. 9567 Implementing Rules and Regulations (2005) over credit rating requirements and the use of SPVs</td>
</tr>
<tr>
<td>Singapore</td>
<td>Permissive legal framework, except for conflicts with bankruptcy laws arising in certain future flow transactions</td>
</tr>
<tr>
<td>Thailand</td>
<td>1997 Securitization Decree 2003 Asset-backed Securitization Act 2004 Special Purpose Vehicle Act</td>
</tr>
</tbody>
</table>

Source: Lejot, Paul, Douglas Arner, Lotte Scho/蚩ibell, Securitization in East Asia, ADB
Asia’s ABS Market

- Despite each nation’s efforts in building an institutional foundation, Asia’s securitization market lags behind that of the US and Europe, in terms of the size of issues and market infrastructure.

Korea’s ABS Market

- **ABS Act**
  - ABS act provides grounds for the adoption of ABS and includes ABS issuance procedures as well.
  - The ABS Act states the basic definitions of securitization, securitization procedures and all the special provisions and regulations to promote the securitization.

- **MBS Company Act**
  - Special Purpose Companies for Mortgage-Backed Securities Company Act (the MBS Company Act) was enacted in January 1999.
  - This act laid the institutional groundwork for MBS issuers.

- **KHFC Act**
  - Following the enactment of the MBS Company Act, Korea Housing Finance Corporation Act was enacted in December 2003.
History of Korea's ABS Market
- Since the Act on Asset-Backed Securitization was enacted in September 1998, ABS have played multiple roles in Korea's capital markets.

Mainly used as a restructuring tool
Financing tools for financial institutions
Real estate-related securitization
Diverse structures
Revitalization of the ABCP market
Restructuring purpose brought into sharp focus again

Asset-backed commercial paper
- ABCP is a short-term financial instrument issued to raise money in the form of commercial paper backed by future cash flows or various assets held by a company or financial institution.
- The majority of ABCP are not based on the ABS Act.
  - Under the Commercial Law, a special purpose company is created for the purpose of issuing commercial paper. This special purpose company acquires assets and issue ABCP.
Korea’s ABS Market

ABCDE issuance by asset type

ABCDE issuance by credit rating symbols

Source: NICE Rating

Korea’s ABS Market

ABC factors for success of ABC Market in Korea

– Adoption of securitization through enactment of securitization law
  • Legal and regulatory obstacles to securitization were removed by the enactment of the ABS Act, which laid the institutional framework for smooth securitization.

– Clarification of “true sale” concept
  • The core to asset securitization is to provide legal and regulatory framework under which an issuer issues securities based on its own credit by insulating the credit risk of assets from that of an originator’s (bankruptcy remoteness).
  • The requirements associated with the “true sale” are clarified through the ABS Act, so as to remove uncertainties.

– Regulatory direction to promote securitization
  • In Korea, regulators strived to form a securitization market swiftly whereas preventing related institutions from being operated beyond their capacity.
  • These efforts contributed to the higher credibility of ABS and subsequent brisk investments. In Korea, a securitization plan has to be registered with the Financial Supervisory Service for ABS issuance.

– Introduction of flexible securitization structure in response to a funding squeeze in the corporate sector
  • Primary CDO, designed to improve this corporate funding structure, provides companies in funding difficulties to raise funds in the capital market using the securitization structure.
3. Cross-border Securitization Cases

Asia’s Cross-border Securitization

- Some Asian nations use cross-border ABS, but Asia does not have a developed regional cross-border market.

- Most cross-border ABS are issued in the euro market, and Hong Kong.
  - Most issues are denominated in the US dollar, and global investors account for a large portion.

- The only cross-border issue denominated in an Asian currency is Korea’s ABS issues in Japan.

- Asia’s regional cross-border issues are not active due to the following reasons.
  - In most Asian nations, except a few, ABS is not actively issued, and this restricts the advancement of Asia’s securitization market.
  - Insufficient data about the performance of assets, and underdeveloped market infrastructure related to ABS issues have impeded the cross-border market development.
  - Lack of the pools of specialized investors who can purchase regional cross-border ABS.
  - Investment banks usually design the ABS structures and underwrite ABS, but they play a limited role in Asia.
Asia’s Cross-border Securitization

- **Korea's cross-border ABS issues**
  - Finance companies, banks, and mortgage agencies issue ABS and MBS overseas.
  - Cross-border issues are used to cut financing costs.

<table>
<thead>
<tr>
<th>Korea's cross-border ABS issues</th>
<th>2008</th>
<th>2009</th>
<th>2010</th>
</tr>
</thead>
<tbody>
<tr>
<td>Issue Amount</td>
<td>50,810</td>
<td>23,774</td>
<td>32,072</td>
</tr>
<tr>
<td>(Number of Deals)</td>
<td>(12)</td>
<td>(6)</td>
<td>(8)</td>
</tr>
<tr>
<td>% of Total Issue Amount</td>
<td>24.7%</td>
<td>6.6%</td>
<td>11.5%</td>
</tr>
</tbody>
</table>

(Unit: KRW 100 million)

Asia’s Cross-border Securitization

- **Korea's cross-border ABS issues**

<table>
<thead>
<tr>
<th>Asset Type</th>
<th>Issuance Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Korea Ace Mortgage Company</td>
<td>Mortgage USD 518 Mil</td>
</tr>
<tr>
<td>Horizon Funding corp.</td>
<td>Credit Card Receivables USD 200Mil</td>
</tr>
<tr>
<td>Horizon Funding corp.</td>
<td>Auto loan USD 300Mil</td>
</tr>
<tr>
<td>KHFC MBB</td>
<td>Mortgage USD 500Mil</td>
</tr>
<tr>
<td>Frontier Securitization XVI</td>
<td>Credit Card Receivables USD 200Mil</td>
</tr>
<tr>
<td>Hyundai Capital Auto Funding VIII</td>
<td>Auto loan USD 300Mil</td>
</tr>
<tr>
<td>Shinhan Card 2010-1 International</td>
<td>Credit Card Receivables USD 300Mil</td>
</tr>
<tr>
<td>KAL Japan ABS Cayman</td>
<td>Air Cargo Receivables JPY 40000 mil</td>
</tr>
</tbody>
</table>
Asia’s Cross-border Securitization

Case: The 6th SME Securitization
- SMEs first issued convertible bonds in Korea, and financial firms pooled the bonds to issue senior and subordinated bonds.
- The Small & Medium Business Corporation took over the subordinated bonds, and the senior bonds were transferred to a SPC in Japan for credit enhancement.
- ABS were issued based on the senior bonds transferred to Japan’s SPC, and Japan Bank for International Cooperation (JBIC) provided additional credit enhancement.
- In the structure, the convertible bonds issued by a Korean SME were used as underlying assets for financing in Japan.
How to Facilitate Cross-border ABS

- In order to boost the cross-border ABS market in Asia, the ABS market in each Asian nation should be revitalized first.
  - There is a growing need to jointly build the ABS infrastructure, and establish a cross-border securitization market in the region through the efforts to facilitate the markets.
  - With diversified infrastructure on which securities with higher credit ratings can be issued and supported, the regional financial markets can be advanced, and this will lead to financial development of the whole region.

- Harmonization of the securitization system in the region
  - By comparing each nation’s securitization system in the region, Asia can draw an appropriate standard for the whole region.
  - Based on this, different securitization systems across nations should be harmonized.
    - Particularly, it is important for a financial regulator to create a window through which each nation communicates smoothly about securitization, and to make efforts to harmonize different regulations and systems across nations.
  - In the US and Europe, a securitization division in SIFMA is reviewing market conditions and regulations, but such a systematic approach has not been found in ASIFMA yet.
  - One possible solution is to establish a sub forum between regulators and ABS experts under ABMF.

- Accumulate data regarding Asia’s securitization.
  - Accumulating efficient data about assets is essential for a well-functioning securitization market and efficient securitization structures.
  - Most Asian countries lack fundamental data to prove the performance of their financial assets.
  - Asian nations need to learn from an active securitization market, and make concerted efforts to build fundamental data about financial assets that are expected to be securitized.
  - Especially, data about mortgage, installment financing, and SMEs’ default rates should be accumulated.
  - In addition, a standard is needed regarding how to collect NPLs.

- Make joint efforts in establishing a securitization disclosure system.
  - Since the global financial crisis, disclosure regulations about securitization have been strengthened.
  - In the eurozone, there is growing interest in building regional database for credit risk transfer.
  - In building a regional securitization market, Asia should consider the recent regulatory changes around the world, and think about how to devise disclosure rules and how to accumulate credit risk transfer data for the whole region.
Introduce the CDO structure in Asia.

- In 2006, JBIC proposed a concept of Pan-Asian EXIM Bond, which is a collateralized bond obligation (CBO) backed by a collection of bonds issued by Asian EXIM banks. Based on this concept, it is worth considering a CBO backed by a collection of bonds issued by government (SME) banks in Asia. In the scheme the CBO is guaranteed by Credit Guarantee and Investment Facility (CGIF). The funds raised through the CBO are invested in infrastructures through development banks.
- In order to boost SME financing in the region, diverse discussions and efforts should be made at the working level about how to advance the previously proposed plan to facilitate SME securitization.

Facilitate project finance securitization.

- Consider using the securitization structure to build infrastructure in the Asian region.
- Consider introducing diversified securitization structures for development projects in emerging nations. International organizations can provide credit enhancement to facilitate project finance in Asia.

Consider establishing a credit enhancement organization for regional securitization.

- Efforts should be made to strengthen the existing credit enhancement tools, for example, increase capitals of CGIF.

Introduce a body to discuss about regional securitization.

- As part of attempts to facilitate regional securitization, establish a consulting body under ABMF, that will help experts discuss about how to facilitate regional cross-border ABS issues.
- Regulators, market experts, issuers, and investors are expected to participate the body.
- In particular, focus on reviewing diversified securitization cases, discovering feasible deals, and implementing deals.
Facilitating and Harmonizing Securitization in the Region

June 30, 2011
Seiwoon Hwang

Cross-Border Securitization: The Mortgage Securitization

- MBS is known to be one of the important candidates to attract cross-border investment if properly designed

- Overall soundness of mortgage market
  - Household loans had been more profitable and less risky than corporate loans, especially for SMEs
  - Delinquency rate shows stable trend amidst economic downturn
  - Severe credit concern is not expected mainly due to the tight regulations so far
Growth of Residential Mortgage Loan in Korea

Household Loan and Mortgage Loan by Commercial Banks

- Proportion of Mortgage Loans

Korean Residential Mortgage Market in 2010

- Household Credit (795.4 trillion)
- Household Loan (745.0 trillion)
- Mortgage Loan (410.6 trillion)
- Banks (289.6 trillion)
- Non-Banks (73.2 trillion)
- Public Entity (47.8 trillion)

Non-banks indicate non-banking deposit taking institutions.
Public entity consists of KHFC and NHF.

- 51.6% of total household debt is estimated to be related to mortgage debts.
- Mortgage related debts by household sector are estimated to reach 64% of disposable income in 2010.
Characteristics of Mortgage Contracts in Korea

- Dominant majority of mortgage contracts in Korea are written as short-term adjustable rate bullet form
  - Typical maturity used to be no longer than 3 years
    - New regulation on mortgage loan help increase contracts with longer maturity
    - Average maturity of new mortgage loans reached 13 years in 2010 due to the regulation on mortgage loans
  - More than 90% are adjustable rate loans
    - The proportion of adjustable rate loans: 92.3%(07) → 92.7%(08) → 93.2%(09)
    - Interest rates are revised very frequently, typically every three months
  - Almost 80% of mortgage borrowers are paying interests only
    - 40% are pure bullet type loans
    - The other 40% are mortgage loans with amortization but still in grace period, most of which are expected to be refinanced when the grace period expires

The mortgage market in Korea: Future Image

- Current Vs. Future Image
  - Bullet → Amortizing
  - Short-term → Long-term
  - Adjustable Rate → Fixed Rate

- Income consideration
  - Opportunity for the capital gains diminishing
  - Market liquidity dries up in the financial turmoil

- Stability for home-buyers
  - Essential for transitioning to the amortization-type mortgage

- Optimal risk allocation
  - Institutions have better interest rate risk management ability than individuals
MBS Vs. Covered Bond: The Role of PHA

- **MBS Vs. Covered Bond**
  - MBS and CB are not mutually exclusive
  - However, in many countries, one dominates the other
  - Countries with Anglo Saxon tend to rely on MBS
  - Need to decide among MBS path, CB path, and MBS-CB joint path

- **Role of PHA**
  - MBS-type securitization => crucial
  - CB-type securitization => ?

Role of the Public Housing Agencies

- **Three important roles of PHAs**
  - Facilitate the issuance of MBS by providing credit enhancement
    - Help development long-term mortgage market and contribute to financial stability
  - Affordable home for middle and low income families
    - Lower cost of home purchase by improving efficiency of resource allocation
  - Promote the development of long-term bond market
    - Majority of MBS possess long-term maturity and provide alternatives to long-term government bonds for institutional investors
Future of Mortgage Securitization Market in Asia

- Mortgage markets in Asian region are still in developmental stage
  - Both mortgage market and MBS market in the region have great potential for further development

- Restriction and reduction of the roles of PHAs are discussed in developed countries, especially in the US
  - PHAs in Asian countries still have a lot to achieve for financial stability, better access to mortgage market, and development of long-term bond market
  - The culprit was not PHAs but the way they are operated
  - We can expect that much can be done through activities of PHAs in the region once proper incentive scheme is imbedded

Suggestions for Mortgage Securitization in the Region

- Improve the harmonization for the different mortgage systems
  - ASEAN+3 need to devise appropriate mortgage regulations
  - A standardized mortgage securitization platform needs to be discussed

- Discuss how to facilitate the mortgage securitization market for Asian countries
  - It is difficult to persuade investors to buy MBS without credit enhancement by issuers
  - PHAs in the region can have a crucial role and should be able to provide credit enhancement facilities necessary for development of MBS market

- Facilitate cross-border mortgage securitization transactions
  - Facilitate cross-border MBS/covered bond issues, with the precondition that each nation reorganizes other countries market system, and builds infrastructure necessary for cross-border securitization
Thank you!

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Phone: 02-3771-0642
1. Many have Robustness of their Market Infrastructure already!

- After the 1997-98 Asian Financial Crisis, All Asian economies we have visited have been making great effort to develop & construct their Capital Market Infrastructure for more than ten years.

- Many of them have developed their own Capital Market Infrastructure to the robust level which they can make fair comparison to those of advanced economies.
What is Capital Market Infrastructure (Elements of the Robustness)

In order to claim Robustness of Capital Market Infrastructure, it is important to show status quo of:

1. **Place/space** for capital market transaction. I.E. Exchange and OTC market.
2. Public infrastructure such as laws, rules and regulations on the capital market.
3. Various system infrastructure of capital market (electronic platform etc.)

Component of the capital market

- Market as the place or space for trade Stock Exchange, off-exchange (OTC) market, and trade execution system - (1)
- Various types of IT communications system
- Financial service market laws, regulations and company laws and regulations and related soft law - (2)
- Safety net, Regulatory agency, Conflict resolution agency (Financial ADR system) - (3)
- Financial expert and educational system - (4)
It is critically important

That for the Capital Market Users
(For Both Domestic and Foreign)
(For Both Investor and Issuer)

- To eliminate legal and regulatory uncertainty,
- To be able to understand related legal provisions clearly,
- To find themselves legal stability (how remote from the legal risks) with common principle behind the markets.

2. The Bond Issuance and Regulatory Framework varies (1/6)

- **Governing Law** for Corporate Bonds Issuance
  - Some use Commercial Law / Companies Act
  - Some use Securities law, etc.

- **Definition of Securities (Bonds)** are stated in
  - Commercial Law / Companies Act, and / or
  - Securities law, and / or
  - Order of the Central Bank, and / or
  - Self-Regulatory Rule, and /or
  - Listing Rules of the Exchange, etc.
2. The Bond Issuance and Regulatory Framework varies (2/6)

- **Competent Authority (Regulator)** sometimes varies based on the category of bonds.
- **Issuing Approval Method** varies.
- **Role of the SROs** varies.
- **Purpose of the Listing of Bonds** varies.
  - e.g. profiling or real listing
- **Obligation for the Listing of Bond** varies.
- **Main Trading Places (OTC / Exchange)** varies.
- **Necessity of the Credit Rating** varies.

2. The Bond Issuance and Regulatory Framework varies (3/6)

- **Method of Registration of Bonds** varies.
- **Status of the Bonds (Bearer / Registered)** varies.
- **Form of the Bonds (Scripless / Physical)** varies.
- **Status of the Scripless Bonds (Complete Dematerialised or Immobilised)** varies.
- **Existence of the exchangeability of the Scripless Bond to the Physical Bonds** varies.
2. The Bond Issuance and Regulatory Framework varies (4/6)

- Method of Transfer of Interest in Bonds varies.
- Finality of Settlement varies.
- Legal Basis and Definition of “Settlement and Clearing” sometimes varies.
- Existence of the Omnibus Accounts varies.
- Existence of the Nominee Concept varies.

2. The Bond Issuance and Regulatory Framework varies (5/6)

- Regulators’ Policy related to the necessity of Disclosure of Real Beneficially Owner differs.
- Documentation Language varies.
- Definition of the Payment Default may sometimes not clear.
- Bankruptcy Procedures varies.
- Existence of the Meeting of Bondholders varies.
2. The Bond Issuance and Regulatory Framework varies (6/6)

- The way of Trustee (Bond Representative / Commissioned Persons) System varies
- The definition of Professional / Institutional investors varies ···

3. Primary and Secondary Markets Regulatory Framework varies (1/2)

- Many regulators concentrate on (Initial) Public Offering Market Regulation.
  - Some still have Merit-Base approach.
  - Many regulators are moving to Disclosure-Based Approach
  - Disclosure-Based Approach focuses on the full disclosure of material information
  - Continuous Disclosure Rules on the Secondary Market may not be developed
3. Primary and Secondary Markets Regulatory Framework varies (2/2)

- Depends on the development stage of the market, treatment of Private Placement differs.
- Private Placement Market can be a Market of Exemption of full disclosure of information.
- Some do not focus on Private Placement Market. (Sometimes outside the scope of the subject of regulation)
- Why not utilize Private Placement Market positively?

Methods of Capital Market Regulations

1. Market Entrance Regulations for Issuers, Investors and Intermediaries
2. Conduct Regulation &/or Code of Conduct for Market Intermediaries (Financial service providers) ⇒ SRO
3. Supervision for financial services providers
4. Center of Market regulation – Disclosure Rules
   - Move from Merit-based to Disclosure-based approach
5. Adjustment of enforceability of laws and regulations
Evolution of Disclosure Rules  
(Depend on Development Stage of the Market)

1. Making **Full Disclosure** for **Public Offering based regulatory environment**  
Objective is -- weak individual investor protection
   - Above situation sometimes means
     1. **No care for Private Placement Market** and
     2. Possibility of **Losing competitive environment for Professional Market participants in the future**

2. Consideration for the future: Make "**Exempt Market**" against full disclosure based regulatory environment to allow making **common platform** for Market Professionals among the ABMF Member Economies

---

Establishment of ABMF  
13th ASEAN+3 Finance Ministers’ Meeting  
2 May 2010, Tashkent, Uzbekistan

- We endorsed the establishment of ASEAN+3 Bond Market Forum (ABMF)
- as a **common platform** to foster standardization of market practices and harmonization of regulations relating to cross-border bond transactions in the region.
(Just for reference) How to make Exemption of Full Disclosure Duty?

- **Instruments for Investment**
  1. Maturity is short (ex. CP, less than one year)
  2. Minimum selling unit (face value) is large (ex. 1 million US dollar or above)

- **Creation of Private Placement Market Category**
  3. Small number of investors (ex. 9/19/49/99 or less)
  4. Professional Investors' Market (New category creation)

- **Others** (Government related, AAA Rated)

---

### PO & PP Rules

**Extract from Thai Bond Market Guide (subject to change)**

<table>
<thead>
<tr>
<th></th>
<th>Private Placement (PP)</th>
<th>Public Offering (PO)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Distribution</td>
<td>Narrow Distribution</td>
<td></td>
</tr>
<tr>
<td></td>
<td>1. &lt; 10 person or</td>
<td>Institution investor &amp; High Net worth investors</td>
</tr>
<tr>
<td></td>
<td>2. For debt restructuring or</td>
<td></td>
</tr>
<tr>
<td></td>
<td>3. Overseas institutional investors</td>
<td></td>
</tr>
<tr>
<td></td>
<td>4. Convertible bond sold to the existing shareholders or</td>
<td></td>
</tr>
<tr>
<td></td>
<td>5. Total number of the bill issued are less than ten</td>
<td></td>
</tr>
<tr>
<td>Issue size</td>
<td>In case of Small (less than 100 million Baht), Cannot be listed (Unlisted)</td>
<td>Not less than 100 million Baht - can be listed.</td>
</tr>
<tr>
<td>(SET rule for Listing qualification)</td>
<td>Not less than 100 million Baht - can be listed.</td>
<td></td>
</tr>
<tr>
<td>Short term bills</td>
<td>SEC Filing Not required (Exempt)</td>
<td>SEC Filing Required (full form, full process)</td>
</tr>
<tr>
<td>SEC Filing of the registration statement and draft prospectus</td>
<td>SEC Filing Not required (Exempt)</td>
<td>SEC Filing Required but Light (Free form, 1-day process)</td>
</tr>
<tr>
<td>Continuous Disclosure requirement</td>
<td>Not required (Exempt)</td>
<td>An annual report is required to be filed with the SEC</td>
</tr>
<tr>
<td>Rating</td>
<td>Not required (Exempt)</td>
<td>Required, but Issue, Issuer, Guarantor rating (any can be used)</td>
</tr>
<tr>
<td></td>
<td>Required, Long-term: issue/ guarantor rating</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Short-term: issue/ issuer/ guarantor rating</td>
<td></td>
</tr>
<tr>
<td>ThaiBMA registration</td>
<td>Not required</td>
<td>Required (newly issued bond)</td>
</tr>
<tr>
<td>Bond representative (Trustee)</td>
<td>Not required</td>
<td>Required (newly issued bond)</td>
</tr>
</tbody>
</table>
Thank You!

shige.inukai@river.dti.ne.jp
ABMF SF-1

China Bond Market Guide
(PART ONE)

Version: No.3_23/June/2011
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I. High Level Structure, Type and Characteristic of the Bond Market

A. Breakdown or Segmentation of the Market

China’s bond market is composed of both the exchange market and the inter-bank market.

These two markets complement each other, interconnect with each other, complete each other, and is integral parts of the Chinese financial markets as a whole.

The inter-bank bond market is an over-the-counter (OTC) wholesale market with market positioning of institutional investors and one-to-one quote-driven trading mode.

In the meanwhile, the exchange bond market is a retail market, in which the individual and small and medium-size institutional investors carry out trading through the concentrated matchmaking method.

Types of bonds available in China’s bond market are increasingly diversified.

The bond categories, from the initial Treasury bonds and corporate bonds, evolve and embrace such a wide range of varieties as the policy bank bonds, central bank bills, general financial bonds, subordinated bonds of commercial bank, hybrid capital bonds, corporate short-term commerical papers, medium term notes, credit asset securitization products, listed companies bonds, local government bonds, international development institution’s bonds and SMEs collective notes.

In addition, bond provisions are becoming more flexible, some innovative varieties with the embedded options and advanced redemption clause emerged.

Moreover, bond trading instrument also witnesses the evolution from spot trading and repurchase trading to bond forward, forward rate agreement, Renminbi interest rate swap, bond lending, credit risk mitigation agreement and credit risk mitigation warranty, and many more.

The financial bonds may now be publically issued in the national inter-bank bond market or to targeted investors.

At present, there is no well-defined concept on professional investors in China. Nevertheless, the majority of investors in the inter-bank bond market are professional investment institutions.

B. Methods of Issuing Bonds

In the bond market of China, the bonds can be issued in two ways: tender through the issue system of the People’s Bank of China and book building.

Currently, Treasury bonds and policy bank bonds are issued by tender through the issue system of the People’s Bank of China (PBOC), while credit products are mostly issued through book building in central book-entry system.

However, with the rapid development of credit bonds in recent years since 2009, the market can substantially accept bonds with a relatively high credit rating.

Non-financial enterprises that satisfy the relevant provisions of “Circular of the People’s Bank of China (Financial Market Department) on Matters Concerning the Issue of Bonds
by Tender through the Issue System of the People’s Bank of China (BSC [2011] No. 11)” can also issue the bond by public tender.

C. Credit Rating System (CRS)

At present, there are eight major credit rating agencies in China’s bond market, of which two are sino-foreign joint ventures, one keeps technical cooperation with a foreign enterprise and the remaining five are domestic-funded ones.

The supervision for the rating system varies with the market segmentation and bond classification.

The People’s Bank of China supervises credit rating in the inter-bank bond market and the credit market; China Securities Regulatory Commission (CSRC) supervises credit rating in the exchange bond market, while the National Development and Reform Commission supervises credit rating for enterprise bonds.

In November 2006, Specification for Credit Rating in the Credit Market and Inter-Bank Bond Market distributed by the People’s Bank of China addressed a unified definition for the classification, symbol and meaning of the medium and long-term, and short-term credit rating in the inter-bank bond market.

According to the related provisions of the Specification, the ranks of credit rating for medium and long-term bond in the inter-bank bond market are divided into nine levels in three classes, symbolically representing in AAA, AA, A, BBB, BB, B, CCC, CC and C. “+” or “-” can be used for each rank except for AAA and the ones below CCC (including), which indicates a slight higher or lower than that of the corresponding rank.

The rank of credit rating for the short-term bond in the inter-bank bond market can be divided into six levels in four classes, respectively represented A-1, A-2, A-3, B, C and D, no slight adjustment can be made to each rank (See Table 1-2 and 1-3).

Table 1-2 Credit Ranks and Corresponding Meanings for Medium and Long-term Bond in Inter-Bank Bond Market

<table>
<thead>
<tr>
<th>Credit Rank</th>
<th>Meaning</th>
</tr>
</thead>
<tbody>
<tr>
<td>AAA</td>
<td>Extremely strong capacity of paying the debt, free from the influence of unfavorable economic environment and extremely low default risk</td>
</tr>
<tr>
<td>AA</td>
<td>Very strong capacity of paying the debt, insignificantly affected by the unfavorable economic environment and very low default risk</td>
</tr>
<tr>
<td>A</td>
<td>Relatively strong capacity of paying the debt, relatively easy to be affected by the unfavorable economic environment and relatively low default risk</td>
</tr>
<tr>
<td>BBB</td>
<td>Moderate capacity of paying the debt, somewhat significantly affected by the influence of unfavorable economic environment and moderate default risk</td>
</tr>
<tr>
<td>BB</td>
<td>Relatively weak capacity of paying the debt, significantly affected by the unfavorable economic environment and relatively high default risk</td>
</tr>
<tr>
<td>B</td>
<td>The capacity of paying the debt somewhat mainly depends on the sound economic environment, and extremely high default risk</td>
</tr>
<tr>
<td>CCC</td>
<td>The capacity of paying the debt extremely depends on the sound economic environment, and very high default risk</td>
</tr>
<tr>
<td>CC</td>
<td>Relatively few protection in case of the bankruptcy or reorganization, the capacity of paying the debt can hardly be guaranteed</td>
</tr>
<tr>
<td>C</td>
<td>Unable to pay the debt</td>
</tr>
</tbody>
</table>

Note: Except for AAA and the ones below CCC (including), “+” or “-” can be used for each rank to address a slight adjustment, representing slightly higher or lower than that of the corresponding rank.

Table 1-3 Credit Ranks and Corresponding Meanings for Short-term Bond in Inter-Bank Bond Market

<table>
<thead>
<tr>
<th>Credit Rank</th>
<th>Meaning</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
</tr>
<tr>
<td>A-1</td>
<td>The strongest capacity of repaying the loan and accrued interest, also the highest security</td>
</tr>
<tr>
<td>-----</td>
<td>--------------------------------------------------------------------------------------------------</td>
</tr>
<tr>
<td>A-2</td>
<td>Relatively strong capacity of repaying the loan and accrued interest, and relatively high security</td>
</tr>
<tr>
<td>A-3</td>
<td>Moderate capacity of capacity of repaying the loan and accrued interest, and the security is vulnerable to the unfavorable economic environment</td>
</tr>
<tr>
<td>B</td>
<td>Relatively weak capacity of repaying the loan and accrued interest, and somewhat default risk</td>
</tr>
<tr>
<td>C</td>
<td>Very weak capacity of repaying the loan and accrued interest, and relatively high default risk</td>
</tr>
<tr>
<td>D</td>
<td>Unable to repay the loan and accrued interest</td>
</tr>
</tbody>
</table>

**Note:** Slight adjustment to each rank is not allowed.

**Source:** The People’s Bank of China, Specification for Credit Rating in the Credit Market and Inter-Bank Bond Market.

### D. Related Systems for Investor Protections (Trustee System, etc.)

The bond market in China has witnessed increasing improvement of *investors’ interest protection mechanism* and enhancement of investor education.

To foster the development of inter-bank bond market, the **People’s Bank of China (PBOC)** establishes a set of market restrictive and risk-sharing mechanism, which specifies the obligation and responsibility of underwriters, accounting firms, law firms, credit rating agencies as well as other intermediates, and makes sure proper sharing of risks among issuers, intermediates and investors.

The **National Development and Reform Commission (NDRC)** puts the accent on protecting the investors’ interest, encourages and guides issuers and underwriters to explore the effective method of credit increment; on the basis of selective bond issuance program, rationalize the scale to reduce the risk; introduce bondholders meeting system, debt proxy system and mortgage assets supervisor system; ask issuers to formulate a practical and feasible debt repayment plan and safeguard measures, guarantee the source of debt repayment.

The **China Securities Regulatory Commission (CSRC)** establishes bonds classification management system, bond trustee system and bond holders meeting system while developing the listed corporate bond markets.

**NAFMII** is vigorously promoting investors protection mechanism in the non-financial enterprise debt capital market and formulated self-regulatory normative documents such as “*the Rules for Meetings of Non-financial Enterprise Debt Holders in the Inter-bank Bond Market.*”

### E. Listing of Bonds & MTNs

Listing of bonds means that the stock exchange acknowledges and accepts a certain type of bonds to be traded on the stock exchange market.

**a. Listing of Corporate Bonds and Enterprise Bonds**

So far, no unified rules for the listing of bonds are formulated in China.

Shanghai Stock Exchange and Shenzhen Stock Exchange separately set down the rules for listing with similar contents.

Both “*The Rules for Listing of Corporate Bonds of Shanghai Exchange Stock (SZZZ [2009] No. 186)*” and “*Rules for Listing of Corporate Bonds of Shenzhen Exchange Stock (SZS [2009] No. 143)*” give a clear provisions for listing conditions, application for the listing, listing approval, information disclosure and sustaining obligations, as well as suspension of listing, resumption of listing and terminating listing, etc.
b. Trading and Circulation of Medium-Term Notes

At present, medium-term notes are only traded and circulated in the OTC market (namely the inter-bank bond market), and are unavailable in the stock exchange market.

According to “Article 13 in Guidelines for Non-Financial Corporate Medium-Term Notes in the Inter-Bank Bond Market,” medium-term notes can be circulated and transferred among the institutional investors in the inter-bank bond market on the working day following the registration date of claim and debt.

F. Governing Laws of Bond issuance

a. Major Provisions on Administration of Issuing Treasury Bonds

“Regulations of Treasury bonds of the People’s Bank of China (Decree of the State Council [1992] No. 95),”

“Measures for the Examination and Approval of the Qualifications for the Members of the Government Bond Underwriting Syndicates (Order 39 of Ministry of Finance of the People’s Republic of China, the People’s Bank of China and China Securities Regulatory Commission),” and

“Circular on Printing and Distributing the Rules for the Issuance of Book-Entry Treasury Bonds by Tender in 2011 (CK [2011] No. 4),” etc.

b. Major Provisions on Administration of Issuing Financial Bonds


“Measures for the Administration on Issuance of Subordinated Bonds by Commercial Bank (Announcement [2004] No.4 of the People’s Bank of China and China Banking Regulatory Commission),”

“Announcement on Relevant Matters Concerning the Issuance of Hybrid Capital Bonds by Commercial Bank (Announcement [2006] No.11 of the People’s Bank of China),”


“Interim Measures for the Administration of the Issuance of Renminbi Bonds in Hong Kong SAR by Financial Institutions Within the Territory of China (Announcement [2007] No.12 of the People’s Bank of China and National Development and Reform Commission).”

c. Major Provisions on Administration of Issuing Short-Term Commercial Papers and Medium-Term Notes
d. **Major Provisions on Administration of Issuing Listed Corporate Bonds**

“Pilot Rules on the Issuance of Corporate Bonds (Order 49 of China Securities Regulatory Commission) and relevant rules issued by the stock exchanges.”

e. **Major Provisions on Administration of Issuing Enterprise Bonds**


G. **Related Legal and Regulatory issues of the Market**

The laws and regulations regulating the bond market can be roughly classified into **four layers** like the laws, statute or market management rules, regulations and normative documents.

a. **The first layer**

The first layer is the fundamental legal system which regulates and ensures the effective operation of the bond market, mainly formulated and approved by the National People’s Congress or Standing Committee.

**Firstly, it is laws relating to market entities,** “the Securities Laws of the People’s Republic of China (promulgated on December 29, 1998, and revised on October 27, 2005)” and “the Commercial Bank Law of the People’s Republic of China (promulgated on May 10, 1995, and revised on October 27, 2005)” were formulated in order to standardize bond market entities.

**Secondly, it is the legal system regulating the economic relation between market entities,** including the Contract Law, Negotiable Instruments Law and Guaranty Law, etc.

b. **The second layer**

The second layer covers various statutes or market management rules, such as “Regulations on Corporation Debt Management (August 2, 1993),” “Interim Regulations on Administration of Futures Trading (May 17, 2002),” etc.

c. **The third layer**

The third layer includes various regulations and administration measures, mainly formulated and issued by the regulatory departments of the financial markets, like “Interim Measures for the Derivative Product Transactions of Banking Financial Institutions (January 5, 2011),” “Measures for the Administration on Issuance of Renminbi Bonds by International Development Institution and Measures for the Administration of Bond Transactions in the National Inter-Bank Bond Market (April 30, 2000),” “Provisions Governing the Issuance of Financial Bonds in the National Inter-bank Bond Market (April 22, 2005),” “Measures for the Administration on
d. The fourth layer

The fourth layer is normative documents and self-regulatory rules regarding specific market operation, such as “the Rules for the Registration of Issuing Debt Financing Instrument in the Inter-Bank Bond Market by Non-Financial Enterprise,” “Self-regulatory Rules on Bond Trading in the Inter-bank Market,” etc.

H. Self-Governing Rules of the Market

In September 2007, the National Association of Financial Market Institutional Investors (NAFMII) was officially established.

The Association is mainly responsible for the self-regulatory management of the OTC market.

The establishment of the Association fills in the blank of self-regulatory organization in OTC market, forming a market management mode that comprises both government supervision and market self-regulatory management.

The practice in most recent years proves that the Association plays an important role in facilitating market expansion, in guiding and regulating the primary market and the secondary market.

Firstly, debt financing instruments of non-financial enterprises saw a rapid expansion and market management is increasingly standardized.

In 2010, the debt financing instrument of non-financial enterprise registered and issued in local currency by the Association reached RMB1.3 trillion, accounting for 76% of the total amount raised by non-financial enterprise through the bond market during the whole year.

A series of rules and guidelines regarding issuance and underwriting, information disclosure, credit rating and market transaction of debt financing instrument were established in succession, and the full-process supervision and inspection, subsequent management, emergency management and emergency response mechanism for the registration and issuance were correspondingly established and improved; risk inspection and pressure tests on issued debt financing instruments were regularly conducted, dynamic monitoring on subsequent information disclosure and implementation of commitments after bond issuance, site inspections to the issuer were also carried out in different levels to prevent market risk substantially.

Secondly, self-regulatory management system for the secondary market was formulated and trading activities in OTC market became standardized.

In order to promote innovations and standardized development of bond derivatives, “the Guidelines on Internal Risk Management of Financial Derivatives Transactions in the Inter-bank Bond Market,” and “Guidelines on Credit Risk Mitigation Tools Pilot Business Projects” were promulgated in this regard.

“The Master Agreement on Trading Financial Derivative Instruments in the Inter-bank Market of China” by National Association of Financial Market Institutional Investors (also known as NAFMII Master Agreement) was published and popularized, which addressed
a unified and standard text for the OTC financial derivatives market in China.

A set of self-regulatory normative documents like “working guidelines for market makers of the inter-bank bond market,” “self-regulatory rules and code of conduct for personnel relating to the trading” were formulated to strengthen self-regulatory management of bond trading behavior of member institutions, to regulate the practicing behavior of related trader, maintain the legitimate competitive order of the market and promote the sound and standardized development of the market.

I. Bankruptcy Procedures

According to “Article 7 (2) of Law of the People’s Republic of China on Enterprise Bankruptcy,” the creditor shall be entitled to ask the debtor to go bankruptcy.
II. Primary and secondary market related regulatory frameworks

A. Provisions Regarding Bond Issuance

When issuing bonds, different types of bonds bear different provisions with respect to information disclosure and credit rating and so on, the specific provisions are as the following:

<table>
<thead>
<tr>
<th>Table 2-1: Provisions Regarding Bonds Issuance</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Treasury Bonds</strong></td>
</tr>
<tr>
<td><strong>Competent Authority</strong></td>
</tr>
<tr>
<td><strong>Approval Method</strong></td>
</tr>
<tr>
<td><strong>Issuance Method</strong></td>
</tr>
<tr>
<td><strong>Information Disclosure</strong></td>
</tr>
<tr>
<td><strong>Credit Rating</strong></td>
</tr>
<tr>
<td><strong>Size of Fund Raised</strong></td>
</tr>
<tr>
<td><strong>Purpose of Funds raised</strong></td>
</tr>
<tr>
<td><strong>Determination of issuing rate</strong></td>
</tr>
<tr>
<td><strong>Bond Maturity</strong></td>
</tr>
<tr>
<td><strong>Main Trading Places</strong></td>
</tr>
<tr>
<td><strong>Registration and Settlement Institutions</strong></td>
</tr>
</tbody>
</table>
B. Provisions Regarding Investors

a. General Rules and Regulations

According to “Measures for the Administration of Bond Transactions in the National Inter-Bank Bond Market” and the related laws and regulations, financial institutions that intend to become a member of the inter-bank bond market shall put on a record with the People’s Bank of China (PBOC).

Financial institutions that want to become a market maker shall make an application to the People’s Bank of China (PBOC).

In addition, financial institutions may also apply for the engagement of agency business of settlement to the People’s Bank of China (PBOC).

Non-financial institutional investors may entrust financial institutions that are qualified agencies for settlement in the inter-bank bond market to carry out bond trading on their behalf.

Whereas securities companies with asset management plans that want to engage in securities assets management business in the inter-bank bond market, shall have separate bond trading accounts for each assets management plan.

NAFMII has formulated self-regulatory management system for the secondary market and promulgated self-regulatory normative documents such as “the Working Guidelines for Market Makers of the Inter-bank Bond Market,” “Self-regulatory Rules for Bond Trading in the Inter-bank Bond Market” and “Rules for the Meetings of the Holders of Debt Financing Instruments of Non-financial Enterprises in the Inter-bank bond Market” to strengthen self-regulatory management of members when carry out trading activities, to regulate the practicing behavior of related trader, maintain the legitimate competitive order of the market and promote the sound and standard development of the market.

In August 2010, the People’s Bank of China (PBOC) promulgated “the Circular on Matters Concerning Pilot Investment in the Inter-bank Bond Market with Renminbi by Three Types of Institutions Including Overseas RMB Liquidation Banks.”

This allows foreign institutions to enter the inter-bank bond market on a pilot investment project and thus brings overseas institutional investors into the inter-bank bond market.

China Securities Regulatory Commission (CSRC) formulated laws and regulations pertaining to the exchange bond market.

“Securities Law of the People’s Republic of China” states that any insider who has access to insider information or has unlawfully obtained any insider information on securities trading may not purchase or sell the securities of the relevant company, or divulge such information, or advise any other person to purchase or sell such securities; Anyone is prohibited from manipulating the securities market in collusion or
collaboration with others to manipulate the securities market; securities companies as well as practitioners are prohibited from committing to any fraudulent act in the process of securities trading, which may harm the interests of their clients.

In accordance with “the Interim Measures for the Administration of Utilization of Insurance Funds promulgated by China Insurance Regulatory Commission in July 2010,” insurance group (holding) company and insurance company shall follow the requirements in proportion as below when using insurance funds: the total book balance investing in the banks’ demand deposit, government bonds, central bank bills, policy bank bonds and money market funds shall be no less than 5% of the total assets of the company at the end of last quarter; the total book balance investing in unsecured enterprise (corporate) bonds and debt financing instrument of non-financial enterprises shall be no more than 20% of the total assets at the end of last quarter.

b. Rules and Regulations on Dealers with Special Qualifications

According to rules and regulations such as the Rules on Market Makers in the National Inter-bank Market, financial institutions can make applications to the People’s Bank of China should they want to commence business in bilateral quotation for bonds and thus become a market maker. Deals through market making can enjoy benefits such as lower trading and settlement costs. NAFMII, under the authorization of the People’s Bank of China, will evaluate the performance of a market maker.

According to the Circular of the People’s Bank of China on Issues Concerned in Application to Bond Settlement Business, financial institutions can make applications to the People’s bank of China should they want to commence business in bond settlement. Once the application has been approved, it can be entrusted by other market participants and to handle the opening and closing of bond custody accounts and settlements on their behalf.

C. Taxation Framework and Taxation Requirements

According to “the Circular of State Administration of Taxation on Issues Concerned in Measures on Business Tax Declaration by Financial Institutions and Insurance Institutions,” “the Circular of Ministry of Finance and State Administration of Taxation on Issues Concerned in Treasury Bonds Exempted from the Corporate Income Tax after Pilot Implementation of the Net Price Trading of Treasury Bonds,” and “the Circular on Issues Concerned in Business Tax Policy of Qualified Foreign Institutional Investors,” the arrangements of business tax and income tax for both qualified domestic institutional investors (QDII) and qualified foreign institutional investors (QFII) are as the following:

![Table 2-2: Tax Provisions for Qualified Domestic Institutional Investors (QDII) and Qualified Foreign Institutional Investors (QFII)](chart)

D. Regulatory Reporting Requirements

a. Reporting of Bond Issuance Information
Pursuant to “the Provisions Governing the Issuance of Financial Bonds in the National Inter-bank Bond Market,” issuers of financial bonds are obliged to disclose relevant information before bond issuance and within its duration. Information shall be disclosed through the websites of Chinamoney.com.cn or Chinabond.com.cn.

When a major event occurs that may affect an issuer's ability to fulfill its debt obligations, the issuer shall in the first instance report to the People's Bank of China (PBOC) and make relevant disclosure in a way prescribed by the People's Bank of China (PBOC).

Before the retirement of the financial bonds, issuers shall disclose an annual report to the investors before April 30 of each year, which includes an account of the issuers' performance situation of the previous year, the financial reports audited by certified public accountants, major lawsuits involved and other matters.

Where the issuance of the financial bonds is backed by a guarantor, the issuers shall also disclose guarantor's financial situation of the previous year in the annual report, the audited financial report, major lawsuits involved and other matters.

Where the financial bonds are issued to targeted investors, the content and format of information disclosure shall be stipulated in the prospectus and the issuance instructions.

The information shall be disclosed to the investors of the financial bond.


Information disclosure shall abide by the principle of honesty and credibility, and there shall be no falsified descriptions, misleading statements or major omissions.

Issuers of debt financing instruments of non-financial enterprise shall disclose information through the websites of Chinamoney.com.cn and Chinabond.com.cn.

Before the retirement of debt financing instruments, when a major event occurs that may affect an issuer's ability to fulfill its debt obligations, the issuer shall promptly make a disclosure to the market.

In accordance with “Regulations on Administration of Enterprise Bonds and Circular of National Development and Reform Commission on Pushing the Development of Enterprise Bonds Market and Simplifying the Matters Relating to the Approval for Insurance,” the application for a public issuance of enterprise bonds shall be truthful, accurate and complete, any information that may have a major impact on investment decisions of investors shall be fully disclosed, the issuers and all parties concerned the issuance of bonds shall bear corresponding liabilities.

According to “the Pilot Rules on the Issuance of Corporate Bonds,” the issuers who apply for the issuance of listed corporate bonds shall ensure a truthful, accurate, complete and a timely disclosure or render relevant information. There shall be no falsified descriptions, misleading statements or major omissions.
b. Reporting of Bond Trading Information

According to the rules and regulations such as “the Measures for the Administration of Bond Transactions in the National Inter-Bank Bond Market” and “the Circular of the People’s Bank of China on Issues Concerned in Application to Bond Settlement Business,” market makers and settlement agencies shall regularly report business performance to the People’s Bank of China (PBOC) and send a duplicate to intermediary platforms or self-regulatory bodies.

E. Possible Challenges and Expected Changes of Regulatory Rules

In recent years, the development of China’s bond market has made a remarkable progress. However, some structural problems are still remaining unsolved:

a. To improve yield curves for different maturities, regulatory authorities shall form a more active and sustainable strategy in building benchmark interest rate.

It shall also redound to improve the liquidity of the secondary market, to facilitate the innovation process of hedging instrument for interest rate risk (such as futures and options) and to implement monetary policy through direct financing instruments.

b. Presently, a big challenge faced by the corporate credit fixed-income market is how to establish a sub-market that can bring in issuers with lower credit ratings, so SMEs, private enterprises that are excluded from the market and enterprises that are relying on higher-cost bank loans can access to the fixed-income market to raise money.

Several innovations in close connections with the SMEs were launched recently, including SMEs’ collective notes and initiation and establishment of China Bond Insurance Co., Ltd. These measures have achieved declared targets partially.

Regarding companies with lower credit ratings planning to enter the market, it involves legal restrictions on risks stipulated by regulators.

A more flexible approach would enable the creation of at least a segment of eligible investment grade companies (BBB-, three levels below the ratings currently accepted by the market) to issue bond.

To have these products attracted investment from appropriate investors; reform measures by both buy side and sell side are needed.

c. Better service for SME financing needs is another challenge.

Shanghai Stock Exchange implements a multi-layer market system, including the main board, SME board and Growth Enterprise Market (GEM) board, which can be deemed as a step forwards to the correct direction.

The GEM board launched in 2009 has been demonstrated an original and successful innovation with bright future, which can facilitate the financing needs for listed startups with big potential for future growth that originally raising money through private equity fund.

The GEM board is expected to play a key role in the financial service chain through
offering an exit channel for private placement.

The establishment of a smooth transmission channel between the private equity fund and public offerings is very important, mainly representing from two aspects: offer a sustainable financing channel for SMEs, and increase the proportion of private enterprises in the stock exchange.
III. Trading of Bonds and Trading Market Infrastructure

A. Trading of Bonds

a. OTC Trading of Bonds

China’s bond market is constituted of Inter-bank market and exchange market.

Inter-bank bond market is mainly an OTC market, and accounts for about 94% of outstanding bond value as well as 99% of bond trading volume.

Inter-bank bond market was established in 1997 and has recorded an average annual growth rate of over 50% since 2005.

The main products of inter-bank bond markets include cash-bond, collateral repo, outright repo, bond lending and bond forward.

<table>
<thead>
<tr>
<th>Year</th>
<th>Cash Bond</th>
<th>Collateral Repo</th>
<th>Outright Repo</th>
<th>Bond Forward</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>1997</td>
<td>0.97</td>
<td></td>
<td></td>
<td></td>
<td>0.97</td>
</tr>
<tr>
<td>1998</td>
<td>3.32</td>
<td></td>
<td></td>
<td></td>
<td>3.32</td>
</tr>
<tr>
<td>1999</td>
<td>7.74</td>
<td></td>
<td></td>
<td></td>
<td>7.74</td>
</tr>
<tr>
<td>2000</td>
<td>68.24</td>
<td>1,578.17</td>
<td></td>
<td></td>
<td>1,646.41</td>
</tr>
<tr>
<td>2001</td>
<td>83.93</td>
<td>4,013.33</td>
<td></td>
<td></td>
<td>4,097.26</td>
</tr>
<tr>
<td>2002</td>
<td>441.17</td>
<td>10,188.52</td>
<td></td>
<td></td>
<td>10,629.69</td>
</tr>
<tr>
<td>2003</td>
<td>3,084.84</td>
<td>11,720.34</td>
<td></td>
<td></td>
<td>14,805.18</td>
</tr>
<tr>
<td>2004</td>
<td>2,504.11</td>
<td>9,310.49</td>
<td>126.27</td>
<td></td>
<td>11,940.87</td>
</tr>
<tr>
<td>2005</td>
<td>6,013.31</td>
<td>15,678.43</td>
<td>222.28</td>
<td>18.10</td>
<td>21,932.12</td>
</tr>
<tr>
<td>2006</td>
<td>10,256.39</td>
<td>26,302.06</td>
<td>289.21</td>
<td>66.39</td>
<td>36,914.05</td>
</tr>
<tr>
<td>2007</td>
<td>15,604.34</td>
<td>44,067.23</td>
<td>725.26</td>
<td>251.48</td>
<td>60,648.31</td>
</tr>
<tr>
<td>2008</td>
<td>37,115.76</td>
<td>56,382.95</td>
<td>1,737.57</td>
<td>500.27</td>
<td>95,736.55</td>
</tr>
<tr>
<td>2009</td>
<td>47,269.94</td>
<td>67,700.73</td>
<td>2,589.13</td>
<td>655.64</td>
<td>118,215.44</td>
</tr>
<tr>
<td>2010</td>
<td>64,043.25</td>
<td>84,653.35</td>
<td>2,940.21</td>
<td>318.34</td>
<td>151,955.15</td>
</tr>
</tbody>
</table>

Data Source: CFETS

Inter-bank market products include government bonds, central bank papers, policy bank bonds, short-term papers, mid-term notes, corporate bonds, financial bonds, local government bonds, collective notes, international development institution bonds, subordinated bonds, hybrid capital bonds, asset-backed securities(ABS), super short-term commercial paper, etc. Currently, policy bank bond, central bank paper and mid-term note are the three most actively traded bonds in inter-bank bond market.

At present inter-bank bond market has over 10000 members, covering all types of financial institutions such as commercial banks, securities companies, insurance companies, and various kinds of investment products like mutual funds and pension funds, among which commercial banks are the most active participants.

Inter-bank bond market facilitates 2 trading modes: bilateral negotiation and market maker. OTC bond market officially introduced market maker mechanism in 2007 to
improve market liquidity and enhance efficiency. Currently 25 market makers provide bid-offer quotation for underlying bonds that cover nearly all types and terms, and 3 of the 25 market makers are subsidiary companies of foreign banks.

Another major market policy, named settlement agency mechanism, allows non-financial companies to invest in the Inter-bank bond market through settlement agent banks. The two mechanisms constitute the major Inter-bank bond market structure and play an effective role in market growth and risk management.

b. Bond Repurchase Market

Bond repurchase (Repo) has two sub-types, collateral repo and outright repo, with the major difference being that the latter involves transfer of bond ownership during the repo period while the former does not. In China’s OTC market, collateral repo accounts for over 97% of total repo market in terms of trading volume.

Terms of collateral repo transactions range from 1 day to 1 year, and are divided into 11 periods categories, including 1-day (overnight repo), 7-day (2-7 days), 14-day (8-14 days), etc. Terms of outright repo are range from 1 day to 91 day. The most actively traded repos categorized in 1-day and 7-day, which account for over 90 percent of repo transactions. Market participants vary from commercial banks, other financial institutions, to non-financial firms and non-institutional investment products.

Based on 1-day, 7-day and 14-day collateral repos, CFETS composes Fixing Repo Rate. Fixing Repo Rate is now one of the key benchmarks for financial market in China, and also widely used in derivative market.

c. PTS / Trading Systems

China Foreign Exchange Trade System (CFETS), also known as National Inter-bank Funding Center, is the unified trading platform for Inter-bank bond market. CFETS has been operating inter-bank bond market since 1997, and now is developed into the unique OTC electronic bond trading platform in China, with comprehensive functions of trade, post trading service, risk management and information service.

CFETS is a concentrated platform which contains all instruments in bond market including cash-bond trading, bond repo, bond forward, and also other OTC instruments like inter-bank offering, and derivatives like IRS, FRA, credit risk mitigation warranty, etc.

On CFETS’ system, negotiation is applied to all inter-bank products while one-click trading（点击成交） is only applied to cash-bond and interest rate derivatives.

CFETS has set up API for members to transfer data from CFETS to their internal system. The STP between CFETS and depositories (CCDC and Shanghai Clearing House) has also been settled, through which transaction data is transferred to settlement system automatically.

CFETS also provides market information like quotes and prices on a real-time basis. As for post trading management, the trading system contains specific module for post trade supervision and risk management.

d. Secondary Market Yields and Terms of Bond Issues

Both CDC and CFETS compose yield curves for inter-bank bond market.
CFETS composes real-time and end-of-day yield curves on six types of bonds. The real-time yield curves are the only real-time benchmarks in China’s inter-bank bond market. Every trading day the first curve is published at 9:30 and the curve is updated hourly until the system closes. The curves are based on benchmark bonds.

Since compiled by CCDC in 1999, Chinabond Yield Curves have been applied widely, serving the aims of market supervisory as well as pricing benchmark, internal control of financial institutions, and performance evaluation of banks, funds, insurance companies, etc.

e. Transparency in Bond Pricing

i. To enhance transparency of bond market especially OTC market, both CFETS and CCDC provide various information services.

ii. CFETS discloses market information, esp. pricing related statistics via trading system on a real-time basis, to provide market member with a thorough and prompt market description, while summarized information is also disclosed on website of www.chinamoney.com.cn.

iii. CCDC also publishes extensive bond market information, including issuance, registration, listing, income payment as well as settlement quotation and OTC bilateral prices, through the website of www.chinabond.com.cn, established by CCDC in 1998.

iv. CFETS and CDCC also undertake the responsibility of market supervisory, to monitor abnormal transactions, which further improve the market transparency of OTC bond market.
IV. Possible Item of Impediments/Restrictions for the Realization of a Cross-border Inter-regional Market

A. Issues Concerning with the Accounting Standards

First, the amendments to relevant items of Accounting Standards for Enterprises are still in process.

In 2005, the Ministry of Finance of China made concentrated efforts on formulating and completing the system of accounting standards for enterprises by drawing comprehensive accounting reform experiences over the past years. In the course of that time, International Accounting Standards Board (IASB) sent experts to China and work together with the Accounting Department of Ministry of Finance. On November 8, 2005, China Accounting Standards Committee (CASC) concluded a joint statement with IASB, stating the system of Accounting Standards for Enterprises formulated by China are converged with the international financial reporting standards. Next, the Ministry of Finance will continue its efforts in pressing the convergence between Chinese Accounting Standards for Enterprises and the international financial reporting standards, and are trying to complete all amendments to Chinese Accounting Standards for Enterprises before the end of 2011.

Secondly, accounting treatments regarding specific bond trading operations are still ambiguous. Taking outright repo as an example, whether it shall be treated as accommodation or spot bonds trading in the course of accounting treatment, no clear provisions can be referred to. In fact, these two methods are very different. If it is treated as accommodation, the bond is still available in the debt accounts in spite of being excluded from the self-operated securities of the reverse repurchaser, the self-operated securities can become negative once the reverse repurchaser sell the repurchased bonds, which shall be a challenge for the accounting concept of our country. If the outright repurchase is handled as spot bond trading, when it is sold for the first time at the book value of the bond, the potential loss for the original holder shall become a real book loss.

B. Issues Concerning with Information Disclosure and Investors’ Protection

At present, there are some differences between the domestic rules and overseas rules for information disclosure, different specific requirements on disclosure documents within the duration, and also different provisions on the language. As such, under current framework of rules for information disclosure for existing debt financing instrument, the introduction of overseas issuers may have the risk of being unable to provide required information disclosure within the duration of the bond.

By taking into account possible complicated situations that may emerge after the establishment of cross-border bond market, the establishment and improvement of relevant investors’ protection mechanism is extremely important.

At present, the domestic bond market has introduced international mechanisms for investors’ protection such as bond agents and bond holders meeting system: Article 7 in Guidelines for Non-Financial Enterprise Medium-Term Notes in the Inter-Bank Bond Market, the Rules for Meetings of Non-financial Enterprise Debt Holders in the Inter-bank Bond Market and Article 23 to Article 31 in Pilot Rules on the Issuance of Corporate Bonds are regulations relating to the investors’ protection, the related provisions shall be continuously improved in combination with the demand for development of cross-border bond market.
V. High Level Description of the Securities Settlement System

A. The Custody System

There are three central securities depositories (CSDs) serving China’s bond market, namely China Central Depository & Clearing Co., Ltd. (CCDC), Shanghai Clearing House (SHCH), and China Securities Depository and Clearing Co., Ltd. (CSDCC). Specifically, CCDC and SHCH are the CSDs for China inter-bank markets (OTC markets), whereas CSDCC is for the exchange markets.

For the Treasury bonds, CCDC plays the role as the central custodian, while the commercial banks and CSDCC work as sub-custodians for the commercial bank OTC bond market and the Exchange bond market respectively. Bonds of other types, however, are in central custody at their respective CSDs.

B. The Securities Settlement Infrastructures

a. CSDs and custodian products

CCDC mainly takes the custodian role for instrument types such as government bonds, central bank bills, financial bonds, corporate credit bonds, MBSs and ABSs, foreign bonds, etc.

SHCH basically deals with innovative instruments and money market tools like Super and Short-term Commercial Papers (SCP), Credit Risk Mitigation Instrument (CRM), etc. CSDCC is responsible for the custody of exchange traded securities, including Treasury bonds, corporate bonds, equities, warrants, ETF funds, ABSs, etc.

b. Transaction confirmation and straight through processing

CCDC and SHCH have realized straight through processing (STP) by connecting the custody systems with the trade system of National Inter-bank Funding Center (NIFC) 1.

In the daytime, the trade system would send the transaction data to the CSDs in near real-time. The CSDs generate settlement instruction, indicating the transaction is to be settled.

c. Settlement cycles

At present, the bond settlement between inter-bank bond market participants is done by CCDC or SHCH in a near-real-time trade-by-trade mode with a settlement cycle of T+0 or T+1. For exchange markets, the settlement cycle is T+1.

d. Settlement methods

Settlement methods of inter-bank bond market include Free of Payment (FOP), Payment against Delivery (PAD), Delivery against Payment (DAP) and Delivery versus Payment (DVP). CCDC and SHCH have realized DVP mechanism by connecting their business systems with China central bank’s RTGS system. For exchange markets, the settlement method is DVP.

e. Bond settlement processing flow chart

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1 China Foreign Exchange Trade System (CFETS) & National Inter-bank Funding Center (NIFC)
<table>
<thead>
<tr>
<th></th>
<th>Inter-bank bond market</th>
<th>Commercial bank OTC bond market</th>
<th>Exchange bond market</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Trading</strong></td>
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<tr>
<td></td>
<td>Trade system of NIFC</td>
<td>Telephone/Broker</td>
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<tr>
<td><strong>Matching</strong></td>
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<tr>
<td>Trade matching</td>
<td>Trade system of NIFC</td>
<td>Trade system of NIFC</td>
<td></td>
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<tr>
<td>Post-trade matching</td>
<td>CCDC/SHCH</td>
<td>CCDC/SHCH</td>
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<tr>
<td><strong>Clearing</strong></td>
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<tr>
<td></td>
<td>SHCH</td>
<td></td>
<td>CSDCC</td>
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<tr>
<td>(To provide CCP net clearing service)</td>
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</tr>
<tr>
<td><strong>Settlement</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>CCDC/SHCH</td>
<td>CCDC/SHCH</td>
<td>CSDCC</td>
</tr>
<tr>
<td><strong>DVP</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Gross DVP</td>
<td>Gross DVP</td>
<td></td>
</tr>
<tr>
<td><strong>Fund Settlement</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>High-Value Payment System(HVPS)</td>
<td>Commercial Banks</td>
<td></td>
</tr>
<tr>
<td><strong>Bond transfer</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>CCDC/SHCH</td>
<td>CCDC/SHCH</td>
<td>CSDCC</td>
</tr>
</tbody>
</table>
VI. Costs and charging methods

Currently, the costs and charging methods in China bond markets involve trading, clearing & settlement, registration & custody respectively.

A. Charging methods for trading

China’s Inter-bank bond market transaction involves the trade system of NIFC and money broking corporations; exchange market in-house trading is through Shanghai Stock Exchange (SSE) and Shenzhen Stock Exchange (SZSE). Treasury bonds are also traded through commercial banks’ counter as well.

a. NIFC charges transaction fees based on the transaction amount from both parties. Transaction fee rates differ for various products or financing maturities, ranging from 0.5 to 2.5 per million², with the ceiling of 1000RMB per transaction.³.

b. Money Brokers’ commission fee rate is subject to negotiation with each client.

c. SSE charges transaction fees and security transaction regulation fees based on the transaction amount from both parties. Transaction fee rate is 1 per million with the ceiling of 100RMB per transaction; security transaction regulation fee rate is 10 per million⁴.

d. SZSE charges transaction fees and security transaction regulation fees based on the transaction amount from both parties. Transaction fee rate for convertible bonds is 40 per million; transaction fee rates for other bonds range from RMB0.1 to RMB10 per transaction. Security transaction regulation fee rate is 10 per million⁵.

e. Commercial banks OTC bond service’s charge is included in their quoted price, therefore no extra fees.

B. Charging methods for clearing & settlement

The clearing & settlement of China bond markets is through CCDC, SHCH, CSDCC and commercial banks counter.

a. CCDC charges settlement fees from both parties for every transaction. For different bond types and settlement methods, the fees range from RMB 100 to RMB 200⁶.

b. SHCH charges settlement fees from both parties for every transaction. Settlement fees range from RMB100 to RMB200 per transaction according to the bond types and settlement methods⁷.

c. CSDCC charges 10 per million as security settlement risk fund from both parties based on the transaction amount⁸.

d. Commercial banks OTC bond service charges RMB50 for non-trade transfer rollout per transaction⁹.

² Data Source: www.chinamoney.com.cn
³ Data Source: www.chinamoney.com.cn
⁴ Data Source: www.sse.com.cn
⁵ Data Source: www.szse.com.cn
⁶ Data Source: www.chinabond.com.cn
⁷ Data Source: www.shclearing.com
⁸ Data Source: www.chinaclear.cn
⁹ Data Source: www.chinaclear.cn
C. Charging methods for registration & custody

Fees for registration & custody of China's bond market are charged by the CSDs.

a. **CCDC** charges issuance & registration fees by a certain proportion of the issuance amount from 0.6 to 1.15 bp according to the issuance amount and maturity\(^9\).

b. **SHCH** charges issuance & registration fees ranging from 0.3 to 0.5 bp of face value according to the bond maturity\(^1\).

c. **CSDCC**'s registration and custody fees include pledge registration fees, cross-market custody fees, etc., from 10RMB to 10000RMB\(^12\).

d. **Commercial Banks** OTC bond service charges 10RMB for the opening of custody account, and 20RMB for cross-market custody per time\(^13\).

\(^9\) Data Source: relative commercial banks websites  
\(^10\) Data Source: www.chinabond.com.cn  
\(^11\) Data Source: www.shclearing.com  
\(^12\) Data Source: According to the data that CSDCC reported to ABMF  
\(^13\) Data Source: Relative commercial banks' websites
VII. Market size / Statistics

A. Data Table about the issuance, custody and settlement of China inter-bank bond market for the recent 5 years (in trillion RMB)

<table>
<thead>
<tr>
<th></th>
<th>Issuance</th>
<th>Custody</th>
<th>Settlement</th>
</tr>
</thead>
<tbody>
<tr>
<td>2005</td>
<td>4.22</td>
<td>7.26</td>
<td>22.87</td>
</tr>
<tr>
<td>2006</td>
<td>5.71</td>
<td>9.26</td>
<td>38.35</td>
</tr>
<tr>
<td>2007</td>
<td>7.98</td>
<td>12.22</td>
<td>63.13</td>
</tr>
<tr>
<td>2008</td>
<td>7.07</td>
<td>15.11</td>
<td>101.32</td>
</tr>
<tr>
<td>2009</td>
<td>8.65</td>
<td>17.53</td>
<td>122.09</td>
</tr>
<tr>
<td>2010</td>
<td>9.51</td>
<td>20.17</td>
<td>162.79</td>
</tr>
</tbody>
</table>

B. China financing structure for the recent 5 years14
(in trillion RMB, or percentage)

<table>
<thead>
<tr>
<th></th>
<th>Total Financing</th>
<th>Bank Loans</th>
<th>% of Total Financing</th>
<th>Treasury Bonds</th>
<th>% of Total Financing</th>
<th>Corporate / Enterprise Bonds</th>
<th>% of Total Financing</th>
<th>Equity</th>
<th>% of Total Financing</th>
</tr>
</thead>
<tbody>
<tr>
<td>2005</td>
<td>31507</td>
<td>24617</td>
<td>78.1</td>
<td>2996</td>
<td>9.5</td>
<td>2010</td>
<td>6.4</td>
<td>1884</td>
<td>6.0</td>
</tr>
<tr>
<td>2006</td>
<td>39874</td>
<td>32687</td>
<td>82.0</td>
<td>2676</td>
<td>6.7</td>
<td>2266</td>
<td>5.7</td>
<td>2246</td>
<td>5.6</td>
</tr>
<tr>
<td>2007</td>
<td>49817</td>
<td>39205</td>
<td>78.7</td>
<td>1790</td>
<td>3.6</td>
<td>2290</td>
<td>4.6</td>
<td>6532</td>
<td>13.1</td>
</tr>
<tr>
<td>2008</td>
<td>60486</td>
<td>49854</td>
<td>82.4</td>
<td>1027</td>
<td>1.7</td>
<td>6078</td>
<td>10.1</td>
<td>3527</td>
<td>5.8</td>
</tr>
<tr>
<td>2009</td>
<td>130747</td>
<td>105225</td>
<td>80.4</td>
<td>8182</td>
<td>6.3</td>
<td>12320</td>
<td>9.4</td>
<td>5020</td>
<td>3.8</td>
</tr>
</tbody>
</table>

C. Statistics of SHCH custody products15
(As of Feb 25, 2011, Accumulative)

<table>
<thead>
<tr>
<th>No. of Securities Issued</th>
<th>Total amount of securities issued (in 100 million RMB)</th>
<th>No. of Settlement</th>
<th>Principal Settled (in 100 million RMB)</th>
<th>Fund Settled (in 100 million RMB)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Super and Short-term Commercial Papers</td>
<td>11</td>
<td>850.00</td>
<td>70</td>
<td>217.15</td>
</tr>
<tr>
<td>Credit Risk Mitigation Warranty</td>
<td>8</td>
<td>6.90</td>
<td>6</td>
<td>2.40</td>
</tr>
</tbody>
</table>

D. Statistics of Exchange-traded bonds transaction16

(1) General Info about Listed Bonds till Feb.2011

<table>
<thead>
<tr>
<th>Bond Type</th>
<th>SSE</th>
<th>SZSE</th>
</tr>
</thead>
<tbody>
<tr>
<td>Government bonds</td>
<td>137</td>
<td>137</td>
</tr>
<tr>
<td>Local government bonds</td>
<td>60</td>
<td>60</td>
</tr>
<tr>
<td>Corporate/Enterprise bonds</td>
<td>264</td>
<td>68</td>
</tr>
<tr>
<td>Convertible bonds</td>
<td>8</td>
<td>5</td>
</tr>
</tbody>
</table>

(2) Bond Turnover of SSE (in billion RMB)

<table>
<thead>
<tr>
<th>Bond Type</th>
<th>2004</th>
<th>2005</th>
<th>2006</th>
<th>2007</th>
<th>2008</th>
</tr>
</thead>
<tbody>
<tr>
<td>Government bonds</td>
<td>339.59</td>
<td>321.94</td>
<td>153.74</td>
<td>126.22</td>
<td>207.59</td>
</tr>
<tr>
<td>Corporate/Enterprise bonds</td>
<td>12.46</td>
<td>31.64</td>
<td>140.64</td>
<td>32.37</td>
<td>30.16</td>
</tr>
<tr>
<td>Convertible bonds</td>
<td>29.87</td>
<td>2491.91</td>
<td>1629.92</td>
<td>1860.89</td>
<td>2430.68</td>
</tr>
<tr>
<td>Repo</td>
<td>4660.18</td>
<td>2491.91</td>
<td>1629.92</td>
<td>1860.89</td>
<td>2430.68</td>
</tr>
</tbody>
</table>

(3) Bond Turnover of SZSE (in billion RMB)

<table>
<thead>
<tr>
<th>Bond Type</th>
<th>2004</th>
<th>2005</th>
<th>2006</th>
<th>2007</th>
<th>2008</th>
</tr>
</thead>
<tbody>
<tr>
<td>Government bonds</td>
<td>0.54</td>
<td>0.79</td>
<td>0.33</td>
<td>0.51</td>
<td>4.66</td>
</tr>
<tr>
<td>Corporate/Enterprise bonds</td>
<td>2.17</td>
<td>2.89</td>
<td>4.03</td>
<td>6.54</td>
<td>32.37</td>
</tr>
<tr>
<td>Convertible bonds</td>
<td>29.87</td>
<td>19.18</td>
<td>10.55</td>
<td>19.74</td>
<td>12.05</td>
</tr>
</tbody>
</table>

14 Data Source: www.chinabond.com.cn
16 Data Source: According to the data that CSDCC reported to ABMF
VIII. Islamic Bond (Sukuk) Market

At present, there is no Islamic Bond (Sukuk) Market in mainland China.
IX. The Direction of Future Development

We are determined to promote the overall sustainable development of the bond market in China, so as to optimize the allocation of market resources and better serve the real economy.

First is to specify the direction of development, which is to further promote the development of OTC bond market for qualified institutional investor and strengthen market discipline and risk-sharing mechanism.

Second is to encourage innovations and improve supervisions and regulations.

Third is to lay a solid foundation for the bond market by enhancing the market infrastructure and risk prevention.

Moreover, it is to strengthen coordination of regulation and form market-wide efforts for development.

Furthermore, it is to promote the connectivity between exchange market and the OTC market based on a clear direction of market development. Last but not least, it is to promote the opening up of bond market in an active and robust way.
NOTE:

This guide was produced from “the Official Comments on ABMF Questionnaire” answer was made by PBOC.
ABMF SF-1

Indonesia Bond Market Guide

Version: No.5_19/June/2011
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   F. Availability of shelf registration and associated documentation requirements
   G. Regulated suspension period (this may relates to investor protection)
   H. Other requirements
   I. Continuous disclosure rules or requirements
   J. Restrictions for investors (investment grade, etc.)
   K. Definition of Qualified Institutional Investors, Professional Investors, if exist
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   M. How to ensure market functions for the finding of Fair Price
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   B. Disclosure & Investor Protection Rules for Issuers
C. Underwriting Rules for Financial institutions
D. Restrictions on OTC Transactions by Residents
E. Credit Rating System and its relation to Regulations
F. Utilization of Shelf-Registration System / MTN
G. Availability of Information in English
H. Restrictions in Accounting Standard
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B. Type of instruments available, segments, tenure, e.g.
C. Basic Market infrastructure required to facilitate Islamic Finance
D. Tax related issues

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A. Overview

Indonesia's bond market has grown steadily in recent years to offer a more diversified array of debt instruments and to cater to a broader investor base. Foreign investors are allowed to invest in the bond market, subject to regulatory approval.

The country’s current legal framework for securitization encourages opportunities for new instruments to be introduced.

As the largest issuer of bonds, the Government of Indonesia regularly taps the local market to finance the state budget.

Bank Indonesia (BI) also issues short-term bank certificates known as Sertifikat Bank Indonesia (SBI).

Bank Indonesia (BI) is settlement platform and depository for government bonds. Alternatively, KSEI, as sub-registry, can facilitate settlement. 95% of government bonds are settled directly at BI, 5% via KSEI.

Corporate bond activities, including conventional and Islamic bond offerings, accelerated significantly beginning in 2003 and have maintained momentum since then.

Islamic bonds, which are based on shari’a principles, play a major role in Indonesian capital markets. In April 2008, the Islamic Shari’a Debt Bill was passed into law to enable the Government to issue Islamic bonds.

The government bonds are listed on the IDX but traded OTC. The corporate bonds are listed on the IDC traded on the IDX’s Fixed Income Trading System (FITS). IDX is the bond pricing agency, appointed by Bapepam for this purpose. And has set up a separate legal entity: Indonesia Bond Pricing Agency (IBPA).

The settlement of the government bonds happens on the Central Bank of Indonesia (BI)-Scripless Securities Settlement System (BI-SSSS), while the settlement of corporate bonds happens on KSEI’s Central Depository and Book-Entry Settlement System (C-BEST). Although they are listed on stock exchange, the trading of government bonds and corporate bonds are mostly done over the counter (OTC).

More than 90% of market trades are in government bonds, and OTC. And just less than 10% of market trades have been done in corporate bonds, on IDX; very few transactions in 2011 so far.

BI maintains omnibus accounts at sub-registry level. KSEI can maintain individual account holder level, but omnibus account at BI.
The Indonesian market is seen as using bottom up approach, i.e. having a significant exchange of information between regulators and participants before regulations are introduced.

Prevailing policy by Indonesian government: foreign investment welcome.

Thus, critical to convince private sector of new initiatives, need to invest, standardise and harmonise.

The current status and expected growth of Indonesian capital markets, and strategies for future development, are detailed in the Capital Market and Non Bank Financial Industry Master Plan 2010-2014, which is linked below.


Summary Table of the characteristics of SBI, government bonds (Government Debt Securities), and corporate bonds:

<table>
<thead>
<tr>
<th></th>
<th>SBI</th>
<th>Government Bonds (GDS)</th>
<th>Corporate Bonds</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td>Regular GDS</td>
<td>Retail GDS</td>
</tr>
<tr>
<td>Form</td>
<td>Scripless</td>
<td>Scripless</td>
<td>Mostly scripless and only few physical</td>
</tr>
<tr>
<td>Tenor</td>
<td>Used to be 1 and 3 months</td>
<td>2-30 years</td>
<td>3 years</td>
</tr>
<tr>
<td>Issuer</td>
<td>Bank Indonesia</td>
<td>Ministry of Finance</td>
<td>Corporation</td>
</tr>
<tr>
<td>Coupon/ Discount</td>
<td>Discount</td>
<td>Fixed Rate: Semi-Annually coupons</td>
<td>Fixed Rate: Monthly coupons</td>
</tr>
<tr>
<td>Minimum denomination</td>
<td>IDR 1 bio Increments 100 mio and IDR 1 mio (in Secondary Market)</td>
<td>IDR 1 bio Increments of IDR 100 mio and IDR 1 mio (in Secondary Market)</td>
<td>IDR 5 mio Increments of IDR 5 mio (in Primary Market) and IDR 1 mio (in Secondary Market)</td>
</tr>
<tr>
<td>Issuance</td>
<td>Competitive auction</td>
<td>Competitive auction</td>
<td>IPO</td>
</tr>
<tr>
<td>Trading</td>
<td>OTC</td>
<td>OTC and on the exchange</td>
<td>OTC and on-the-exchange</td>
</tr>
</tbody>
</table>
### B. Types of Bonds

Debt securities instrument or Efek Bersifat Utang (EBU))

1. **Government bonds (Treasury bonds)**
   
   In September 2002, the Government Debt Securities Law established a legal framework for issuing both domestic and external debt securities, and authorized the Ministry of Finance (MOF) to issue treasury bonds. Since 2003, MOF has issued treasury bonds of various maturities, with both fixed and floating rate coupons, in an effort to create a meaningful government yield curve.

2. **Government bonds (Promissory notes) (SUN)**

   Government Bonds called *Surat Utang Negara* (SUN), is securities in the form of *promissory note* in Rupiah or foreign currency which guaranteed by Republic of Indonesia for its payments of interest and principal in accordance with the validity period.

   Promissory notes are zero-coupon perpetual obligations of the Government to BI and are not traded on the market.

   There are two kinds of SUN: *Surat Perbendaharaan Negara* (SPN) and *Obligasi Negara*. This issuance is based on law number 24/2002

3. **Government Islamic Bonds (Sukuk) (SBSN)
Government Sharia Bond called Surat Berharga Syariah Negara (SBSN), or Sukuk Negara, is bond issued by the government based on sharia principles, as evidence for the inclusion of SBSN's Asset, in in Rupiah or foreign currency.
The government sukuk/shariah securities issuance is based on law number 19/2008. Retail Sukuk exist. Anyone can invest.

Distinction between SUN and Sukuk:

SUN – government securities issued without specific underlying assets; based on general credit worthiness.
Sukuk introduced in 2008, by Law No. 19, based on Shariyah principles; requires specified purposes, may require specific underlying assets to comply.

Treatment for both SUN and Sukuk is same across settlement and e.g. default – bond holder meeting has authority.

Bond trustee/trust agent (banks, for each bond/Sukuk) has obligation to publish event of default, convenes bondholder meeting who decides on future actions; conditions evident in bond contract.

4. Hedge bond

Hedge bonds are non-tradable bonds issued to banks to hedge their net open positions.
Hedge bond tenors are between 3 months and 3 years, with a coupon at the 3-month Singapore Interbank Offered Rate (SIBOR) plus 2%. The coupon is payable quarterly and linked to the rupiah–dollar exchange rate.

5. Municipal Bond (Obligasi Daerah)

Municipal Bonds are issued by province/district government for financing public utilities project.

6. Corporate Bond and Medium Term Note (MTN)

Corporate Bond and Medium Term Note (MTN) are issued by the state owned company or private company.
When issuing bonds, ratings are required. However, after the issuance of bonds, the rating is not required. It is said that this point is a problem.

7. Corporate Islamic Bonds (Sukuk)

8. Convertible Bonds

9. Asset-backed securities

Asset-Backed Securities is Debt Securities issued with underlying assets as the basis (Bapepam Rule No.IX.C.9)

C. Money Markets Instruments
1. Treasury Bills (SPN)

SPN are widely known as Treasury Bills (Surat Perbendaharaan Negara). A short term notes issued by the Government and sold on discount. The maturity is of maximum 12 months.
In May 2007, the Government issued its first treasury bills with a 12-month tenor and a total value of IDR2 trillion. The Government issues treasury bills to maintain bond market stability, bolster liquidity, and fund the budget deficit.
In March 2011, the Government issued treasury bills with a 3-month tenor, a move aimed at deepening the market for short-term financial instruments.

2. Certificate of the Central Bank (Sertifikat Bank Indonesia) (SBI)

SBI – Certificate of the Central Bank (Sertifikat Bank Indonesia), issued by Bank Indonesia (BI) (the Central Bank of Indonesia). SBI’s were issued in two tenors (28 days and 3 months).
Prior to the advent of treasury bills, the Sertifikat Bank Indonesia (SBI) was the main tool used by Bank Indonesia (BI) for open-market operations.
SBIs were issued by BI to control the liquidity of the banking system.
SBIs were the most actively traded money market instrument in Indonesia.
Beginning June 2010, SBI certificates were auctioned on a monthly basis with maturities of 28, 91, and 182 days.
BI also issued 28-day shari'a-compliant SBIs on a monthly basis.
In November 2010, Bank Indonesia (BI) stopped issuing 3-month SBIs and instead began offering term deposit instruments to absorb excess bank liquidity and limit foreign holdings.
Subsequently, in February 2011, BI announced that it would no longer issue SBIs with maturities of less than 9-months.

3. Commercial Paper (Surat berharga komersial)

Commercial paper is the short term securities in the money market, with no guarantee, issued with discount by companies. Usually these instruments are not used for long-term investment but rather just for funding of purchased inventory or to the management of working capital.
Normally all these instruments are purchased by financial institutions because of the face value is too large for private investors, and these are included in a very safe investment so that the yield of commercial paper is also low.
Because the maturity of this commercial paper not exceeding 9 months as well as its use only for the purposes of the payment transaction then the commercial paper was excluded from the obligation of registration as a securities can be traded by supervisory commissions (the Securities and Exchange Commission-SEC).

Structure of Indonesian Bonds and CP

<table>
<thead>
<tr>
<th>Tenor</th>
<th>Corporate Bonds</th>
<th>Commercial Paper</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Mostly 5 years</td>
<td>Less than 270 days</td>
</tr>
<tr>
<td>Currency</td>
<td>Rupiah</td>
<td>Rupiah and US dollar</td>
</tr>
<tr>
<td>----------</td>
<td>--------</td>
<td>---------------------</td>
</tr>
<tr>
<td>Structure</td>
<td>Fixed and floating rates; mostly guaranteed</td>
<td>Zero coupon with bullet payment on maturity; clean if guaranteed</td>
</tr>
<tr>
<td>Rating requirement</td>
<td>Yes, as of Sept. 1994</td>
<td>Yes, as of Feb. 1996¹</td>
</tr>
<tr>
<td>Method of calculation</td>
<td>Yield-to-maturity</td>
<td>True discount</td>
</tr>
<tr>
<td>Others</td>
<td>Pari passu with other unsecured indebtedness</td>
<td>Pari passu with other unsecured indebtedness</td>
</tr>
</tbody>
</table>

4. Repurchase Agreement

Indonesia’s repurchase market is jointly managed by Bank Indonesia (BI), the Indonesian Securities Inter-Dealer Association, and the Indonesian Fixed-Income Dealer Association.

BI has established provisions for secondary market trading of Sertifikat Bank Indonesia (SBI) notes under repurchase agreements (repo).

The Government launched a repo market in 2004 and a Master Repurchase Agreement (MRA) in 2005. The MRA is the benchmark for repurchase transactions, which are set at the BI rate plus 3% for overnight repurchases.

In January 2009, BI began allowing repo transactions using government bonds denominated in foreign currency.

http://www.bi.go.id/web/en/Peraturan/Moneter/se_100208.htm
http://www.bi.go.id/biweb/Html/SekiTxt/T3x401.txt

D. Listing of Debt securities

1. Role of the IDX for Debt securities listing

All government bonds and almost all corporate bonds are automatically listed on the Indonesia Stock Exchange (IDX). However most of trading is done over the counter (OTC).

In June 2005, the stock exchange introduced Fixed Income Trading System (FITS) to facilitate the trading of bonds in the exchange.

In August 2006, Bapepam-LK appointed the stock exchange as the Bond Transactions Reporting Center.

With effect from September 1, 2006, all government bonds and corporate bonds transactions must be reported to Bapepam-LK through the stock exchange.

¹ CP grew rapidly in the early 1990s as it offered a substitute for bonds. Since CP programs can be rolled over almost automatically, they are economically the same as floating-rate bonds, but involve less cost and effort.

The market received a further boost in September 1994, when Bapepam introduced a requirement that bonds (i.e., not CP) could be listed only for rated companies, although it did not specify a minimum rating. But just over a year later, a similar requirement for CP introduced by the Bank of Indonesia (BI) effectively stifled the market. A central bank regulation in 1996 put a stop to the growth of the CP market. According to the regulation, Indonesian banks could arrange, invest in, or act as paying agent only for CP issues that were rated investment grade. Outstanding CP shrank from a peak of about Rp 10 trillion in 1995 to Rp 5.9 trillion in 1996 and Rp 0.8 trillion in 1997. The most affected CP issuers were finance and property companies which, in 1995, were the two major issuers of CP representing about 32 percent of the total market. As a result, many companies switched their funding sources to other instruments, particularly offshore MTNs and FRNs.
This means all government bonds and corporate bonds are listed on the IDX.

This mechanism helps disseminate the bond prices to the market and act as a price reference for various purposes.

It now requires securities companies, bank or other parties appointed and approved by Bapepam-LK to report all corporate and government bonds transaction through stock exchange within a shorter time period of 30 minutes.

a. Government Bonds

Bidding in the primary market is done by primary dealers via BI-SSSS system.
In February 2007, the Ministry of Finance has appointed 14 banks and 4 securities firms as the primary dealers who act as market makers for government bonds.
The primary dealers also act as liquidity provider in the secondary market for all types of government bonds, including Treasury Bills.

b. Corporate Bonds

Corporate bonds are traded in two trading modes:

i. Exchange trading, facilitated by IDX
ii. Over the counter

2. Exchange Listed Market

There is only one stock exchange in Indonesia, the Indonesia Stock Exchange (IDX).
IDX came into existence as a mandate of Bapepam-LK’s capital market master plan 2005-2009 which stipulated the merger of previous exchanges, JSX, and SSX.

Debt Securities listed on IDX consist of:

a. Corporate bonds is bond issued by National Private Company, including BUMN and BUMD.

b. Government bonds is bonds Issued by the Government in accordance with Law No. 24 Year 2002, including State Bond (Including Bond Retail/ORI) and Treasury Bills (T-Bills)

c. Corporate Sukuk is a Fixed Income instruments are issued based on Sharia principles in accordance with Bapepam-LK Rule No. IX.A.13 concerning Sharia Securities. Corporate Sukuk Revenue based on contract contained in Bapepam-LK rule concerning Contracts used in Sharia Securities Contract.

d. State Sharia Securities/SBSN or Corporate Sukuk is Securities issued by the Government based on Sharia in accordance with Law No. 19 Year 2008 concerning Government Sharia Securities (SBSN).
e. Asset-Backed Securities is Debt Securities issued with underlying assets as the basis.

Although they are listed at IDX, these instruments are also allowed traded off exchange (OTC).

3. Non-listed Market

Debt Securities that not listed on IDX consist of:

a. Non-tradable Government Debt Securities and Nontradable Sukuk;

b. MTN (see 6 below) and Some Corporate Bond.

4. Purpose of Bonds listing

In most cases the purpose of Bonds listing on the Indonesia Stock Exchange (IDX) are just for (1) profiling (reporting), (2) regulatory, (3) price discovery and (4) Fixed Income Trading System (FITS) providing purposes.

5. Listing information of Bonds

The Stock Exchange publish the listing of SUN based on official information from Ministry of Finance no later than one trading day following the date of SUN issuing.

Prior to the listing of Obligasi Daerah (provincial/municipal bonds) on Stock Exchange, the region which do IPO of Obligasi Daerah has to sign first the Preliminary Agreement of Securities Listing with Stock Exchange and follow all procedures on it. In case Registration Statement becomes effective, referred region shall submit application for listing. The listing procedures follow the provision of Initial Listing of Securities.

The Information Statements which Corporate Bond will be listed on Stock Exchange with should be disclosed in Registration Statement and accordance with the listing requirement on Stock Exchange. The listing should be done no later than one working day following the date of securities’ delivery.

6. Registration of MTN programme to KSEI

Indonesian regulatory framework does not specifically address the registration of MTN, but it regulates the registration procedures for bonds and sukuk. Nevertheless, KSEI as CSD provides service for its registration. KSEI plays a role of the domestic MTN Programme listing.

In order to facilitate the issuance of MTN which allows a firm to issue a series of bonds within a particular period with only once registration statement submission, Bapepam-LK just released a new regulation on shelf registration.

E. Methods of Issuing Bonds

1. Government bonds (Sukuk) (SUN dan SBSN)

Under UU SUN Nomor 24 Tahun 2002 tentang Surat Utang Negara dan UU 19 Tahun 2008 tentang Surat Berharga Syariah Negara, the authority to issue SUN and SBSN is on the government which implemented by the Ministry.

In terms of the issuance of SUN and SBSN, Minister have to consult previously with BI and approved by Parliament to the maximum net value of SUN or SBSN which to be issued by the Government in a budget year.

The approval including the payment of all interest and principal obligations arising as a result of the issuance of SUN referred or incudes payments of total obligations of benefits and Par Value arising as a result of the SBSN issuance referred and also the State Property which is SBSN's Asset.

The issuance and offer for sale of SUN and SBSN through (1) auction, (2) bookbuilding, (3) private placement in local or international primary market is set further in:

a. PMK Nomor 50/PMK.08/2008 tentang Lelang Surat Utang Negara di Pasar Perdana
b. · PMK Nomor 08/PMK.08/2009 Penjualan Surat Utang Negara dengan cara Private Placement di Pasar Perdana Dalam Negeri
e. PMK Nomor 36/PMK.06/2006 tentang Penjualan Obligasi Negara Ritel di Pasar Perdana
g. · PMK Nomor 152/PMK.08/2008 Penerbitan Surat Berharga Syariah Negara dalam Valuta Asing di Pasar Perdana Internasional
h. · PMK Nomor 75/PMK.08/2009 tentang Penerbitan Dan Penjualan Surat Berharga Syariah Negara Dengan Cara Penempatan Langsung (Private Placement)
i. · PMK Nomor 11/PMK.08/2009 tentang Penerbitan dan Penjualan Surat Berharga Syariah Negara di Pasar Perdana Dalam Negeri dengan cara lelang
j. PMK Nomor 118/PMK.08/2008 tentang Penerbitan dan Penjualan Surat Berharga Syariah Negara dengan cara Bookbuilding di Pasar Perdana Dalam
Government Debt Securities:

1. Domestic issuance:
   a. Auction (T-bills, T-bonds), twice a month based on calendar of issuance) (Finance Minister Regulation No. 50/PMK.08/2008 regarding Government Debt Securities Auction In Primary Market);
   b. Book building (for retail bonds) (Finance Minister Regulation No. 36/PMK.06/2006 regarding Retail Bonds Issuance In Primary Market); and further revised by Finance Minister Regulation no. 10/PMK.08/2007; and 172/PMK.08/2010;
   c. Private placement (for specific securities) (Finance Minister Regulation No. 08/PMK.08/2009 regarding Government Debt Securities Private Placement Issuance In Domestic Primary Market)

2. International Issuance:
   a. Book building/public offering (for global bonds) and private placement (for specific securities) : Finance Minister Regulation No. 217 /PMK.08/2008 regarding Foreign Government Debt Securities Issuance In International Market; further revised by Finance Minister Regulation: No. 32 /PMK.08/2009; No. 170 /Pmk.08/2009;

3. Government Sukuk
   a. Domestic issuance:
      i. Auction (bonds based on calendar of issuance)
      ii. Book building (for retail bonds)
      iii. Private placement
   b. International issuance:
      i. Book building (for global sukuk)
      ii. Private placement (for specific issuance)

4. Corporate Bond
   a. Submission of Registration Statement

   To be able to conduct a Initial Public Offering (IPO), issuer have to submit the Registration Statement along with supporting documents according to the registration procedures for IPO as set out in:

   Peraturan Bapepam dan LK Nomor IX.A.1: Ketentuan Umum Pengajuan Pernyataan Pendaftaran dan Nomor IX.C.1: Pedoman Mengenai Bentuk Dan Isi Pernyataan Pendaftaran Dalam Rangka Penawaran Umum,
And also fully responsible for the accuracy, adequacy, truth, and fairness opinion of all information contained in Registration Statement with it’s supporting documents.

Underwriter, Capital Market Supporting Professionals along with other Party who provide advice or information and with their approval contained in the Registration Statement, is responsible for it’s statement and opinion in reffered document sent to Bapepam and LK. Bapepam and LK then make receipt as proof of the delivery. Furthermore, the process of IPO has to comply with Peraturan Bapepam dan LK nomor IX.A.2: Tata Cara Pendaftaran Dalam Rangka Penawaran Umum.

b. Request for Amendment and/or Additional Information

Bapepam and LK could request for amendment and/or additional information to issuer (it’s Registration Statement considered have been resubmitted to Bapepam and LK by the date of amendment). Issuer have to delivered amendment and/or additional information of Registration Statement no later than 10 (ten) working days after issuer has received request from Bapepam and LK.

Publication of Summary Prospectus, Prospectus, and Preliminary Prospectus
After the document already completed, with or without request for amendment and/or additional information, Bapepam and LK gives permission to the publication of Summary Prospectus and issuer have to publish it within 2 (two) days at least in Indonesian language newspaper. Where issuer would conduct bookbuilding, the IPO could only been done after Bapepam and LK gives statement that issuer be able to do the bookbuilding.

Bookbuilding period will be made within 21 working days.
Issuer have to confirm Bapepam-LK concerning quantity an offering price of the securities, Underwriter guarantee, and/or bond interest rates or interest of Sukuk.

5. Effectiveness of Registration Statement

Registration Statement becomes effective on basis of the passage of time (45 days from date of receipt of Registration Statement by Bapepam-LK in complete, or from date of last change by Issuer or which requested by Bapepam-LK to be fully) or effective notice from Bapepam-LK that there is no further need for amendment and/or additional information.

Publication of revision and/or additional for Summary Prospectus
Since Registration Statement becomes effective and before the commencement of the IPO, issuer have to publish any revision and/or additional for Summary Prospectus, concerning additional information and effective date within one working day at east in one Indonesian language newspaper following the effectiveness of Registration Statement. Along with the publication of additional information, issuer could do the IPO.

Period of IPO, Allotment, and Report the Result of Initial Public Offering
In order to perform IPO, securities could be offer by Underwriter with assistance from securities selling agent.
Issuer obliged to execute IPO within 2 working days since Registration Statement becomes effective.
The period of IPO will be at least one working day and a maximum of 5 working days.

In the event of termination of trading on Stock Exchange for at least one trading day during the IPO, issuer could make an extension of IPO for same period with the termination referred.

Payment for reservations of IPO shall be paid no later then the time of securities’ delivery.

In terms of oversubscribed, then allotment should be held. The allotment should be done no later than 2 (two) working days following the end of IPO period.

Listing of the securities offered in the IPO should be done no later than one working day following the date of securities’ delivery.

Underwriter and Issuer (if there is no underwriter) shall submit Report Result of IPO to Bapepam-LK no later than 5 (five) working days after the date of allotment, along with Allotment Report as stated in Peraturan Bapepam dan LK Nomor IX.A.7 tentang Tanggung Jawab Manajer Penjatahan Dalam Rangka Pemesanan Dan Penjatahan Efek Dalam Penawaran Umum.

Flow process of IPO as stated in attachment of Peraturan Bapepam dan LK nomor IX.A.2: Tata Cara Pendaftaran Dalam Rangka Penawaran Umum.

6. Sustainable Public Offering

Sustainable Public Offering is IPO for EBU and/or Sukuk which held sustainably as regulated in Peraturan Bapepam dan LK Nomor IX.A.15 tentang Penawaran Umum Berkelanjutan.

Sustainable Public Offering in order to provide convienence for issuer or public company with good performance to make IPO of EBU and or Sukuk sustainably.

Sustainable Public Offering should be implemented no longer than 2 years since the effectiveness of Registration Statement with certain criteria for both the issuer and securities.

F. Public Offering Market / Private Placement Market

1. Public Offering Market

   a. Auction

   Each Party could invest in primary market with auction which could only be done for SUN or SBSN.

   That auction is conducted by entering competitive and/or non-competitive bids in a predetermined bidding period, via system provided by agent who conducted the auction of SUN or SBSN (Peraturan Menteri Keuangan/PMK Nomor 50/PMK.08/2008 tentang Lelang Surat Utang Negara di Pasar Perdana & PMK Nomor 11/PMK.08/2009 tentang Penerbitan dan Penjualan Surat Berharga Syariah Negara di Pasar Perdana Dalam Negeri Dengan Cara Lelang).

   For the auction of short term SPN or SBSN could be followed by auction’s participant, Bank Indonesia (BI), and/or Lembaga Penjamin Simpanan (LPS).

   Meanwhile for the auction of long term Obligasi Negara or SBSN could be followed by auction’s participant and/or LPS.

   For Government Debt Securities, participants of the auction are Bank or Securities Company appointed by Minister of Finance as primary dealers that entitle several
rights and obligations. Meanwhile, for Sukuk (SBSN), participants are Bank or Securities Company appointed by Minister of Finance as auction participant only.

b. Bookbuilding

i. SBSN
The issuance and offer for sale of SBSN could be done in way of bookbuilding in a period specified under PMK Nomor 118/PMK.08/2008 tentang Penerbitan dan Penjualan Surat Berharga Syariah Negara dengan cara Bookbuilding di Pasar Perdana Dalam Negeri. Any individual or group of people and/or wealth organized either in the form of corporation or non corporation could propose offer of SBSN via bookbuilding.

ii. Corporate Bond
In case of issuer intend to conduct a Public Offering (bookbuilding), it could only be done after Bapepam and LK gives statements which stated that issuer has been able to do the bookbuilding. It made within 21 (twenty one) working days. (Peraturan Bapepam dan LK nomor IX.A.2 : Tata Cara Pendaftaran Dalam Rangka Penawaran Umum)

2. Private Placement Market

The issuance and offer for sale of SBN or SBSN could be done by The Government through Private Placement (with addressed to the Party with the direct placement) with the provisions and requirements of SBN/SBSN accordance to the agreement and could only be done in domestic or international Primary Market (PMK Nomor 129/PMK.08/2009 tentang Perubahan atas PMK nomor 152/PMK.08/2009 tentang Penerbitan Surat Berharga Syariah Negara dalam Valuta Asing di Pasar Perdana Internasional, PMK Nomor 75/PMK.08/2009 tentang Penerbitan Dan Penjualan Surat Berharga Syariah Negara Dengan Cara Penempatan Langsung (Private Placement) and PMK Nomor 08/PMK.08/2009 Penjualan Surat Utang Negara dengan cara Private Placement di Pasar Perdana Dalam Negeri).

There is a specific regulation concerning issuance and offer for sale for SUN denominated in Japanese Yen.

There is also Private Placement Market for MTN and Corporate Bond which could be registered by CSD (KSEI).

G. Professional (wholesale) Market / Retail Market

1. Professional (wholesale) market

Usually is done off-exchange (OTC), and also subject to the reporting obligation to regulator. (not specified yet)

2. Retail Market

Both Obligasi Ritel Indonesia (ORI) and SBSN Ritel is government debt securities addressed to individual who is Indonesian citizen through selling agent (PMK Nomor 36/PMK.06/2006 tentang Penjualan Obligasi Negara Ritel di Pasar Perdana, PMK Nomor 172/PMK.08/2010 tentang Perubahan kedua atas PMK Nomor 36/PMK.06/2006 tentang Penjualan ORI, PMK Nomor 10/PMK.08/2007 tentang Perubahan Atas PMK Nomor 36/PMK.06/2006 tentang Penjualan Obligasi Negara
H. Definition of Professionals / Professional Investors

Indonesia does not have specific definitions on this type of investors. Bapepam+LK is working on definitions of wholesale/retail and professional/individual investors.

I. Credit Rating System (CRS)

http://asianbondsonline.adb.org/indonesia/structure/participants/rating_agencies.php

Issuer who will issue EBU should obtain rating of referred EBU from Credit Rating Agency (CRA), based on Peraturan Bapepam dan LK nomor IX.C.11: Pemeringkatan EBU, who is holding a business license from Bapepam and LK based on Peraturan Nomor V.C.2: Perizinan Perusahaan Pemeringkat Efek. Rating is an opinion from CRA concerning ability of parties who rated to meet payment obligations in a timely manner (company rating) and/or related to the securities issued by referred parties (instrument rating). Ratings could be done to:

a. EBU, Sukuk, Asset Backed Securities or other rated securities;

b. Party as an entity, including Mutual Funds and Real Estate Investment Trust in form of Collective Investment Contract.

PT ICRA Indonesia, PT Pemeringkat Efek Indonesia and PT Fitch Ratings Indonesia is existing CRA in Indonesia.

Indonesia is the only jurisdiction that imposes rating requirements for bond seeking listing status.

J. Bond Related Systems for Investor Protections (Trustee System, etc) (this part should be confirmed)

1. Trustee (wali amanat) System

http://www.bapepam.go.id/WA/index.htm

Generally speaking, provisions concerning trustee relationship between of Trustee (wali amanat) and Issuer can be set in order to protect debt securities instrument (EBU) holder.

There are generally two structures for bond issues: the fiscal agent (paying agent) structure or the trustee (wali amanat) structure.

The rights and obligations of the bondholders and the issuer are different depending on the structure.

No bond trustee/trust agent for government securities.

KSEI is fiscal agent for corporate bonds, BI for government bonds.

a. Paying agent (Fiscal agent) (KSEI) structure:
A paying agency (or fiscal agent) agreement is executed between the issuer and the paying agent (as the principal paying agent of the issuer: The central depository for corporate bonds (KSEI)).

The issuer pays the interest or the principal to the paying agent and the paying agent pay the amounts of interest or principal to the bondholders.

The paying agent also has other functions, e.g. keeping records of payments on the bonds as register.

Fiscal agent (which is KSEI for corp bonds) makes report on payment failure.

As the paying agent is the agent of the issuer, it does not represent the interests of the bondholders.

b. Trustee (wali amanat) structure:

The trustee (which in bank) is the representative of the bondholders and exercises the bondholders’ rights on behalf of the bondholders and monitors the performance by the issuer of its obligations under the bonds.

To represent the interest of EBU holder, both inside and outside the court in accordance with Trustee Contract and regulations.

To bind itself to carry out main duties and responsibilities mentioned above since the sign of Trustee Contract with Issuer, however such representation shall be effective at the time of EBU has been already allocated to the investors.

Trustee (which is bank) calls for bondholders meeting. Then trustee works with issuer to execute bondholder meeting directions. Referral to courts considered inefficient.

To perform duties based on Trustee Contract (‘trust deed’) and other related documents.

Grace periods, if any, stated in bond trust deed.

To provide all information in relation with its duties as Trustee to Bapepam-LK.


c. WALI AMANAT

http://www.bapepam.go.id/WA/bottom.htm

(simple translation to English should be altered)

TRUSTEES (WALI AMANAT)

Trustees represent the interests of holders of Securities which are debt or sukuk both inside and outside the Court. In this case the Trustees authorized by this Act to
represent the holders of securities are debt or sukuk, perform legal actions related to the interests of holders of securities are debt or sukuk, including doing prosecution rights of holders of securities are debt or sukuk both inside and outside the Court without requiring a power of Attorney from the holders of securities are debt or sukuk.

Perwalian manatan activities undertaken by commercial banks and other parties are defined by government regulations to be able to conduct business activities as Trustees. Public Bank or other party must first be registered on the Bapepam-LK. As for the requirements and procedures for the registration of Trustees arranged further by government regulation.

User Services Trustees determined in the regulation the definition of "use of the services of Trustees" is the use of the services of Trustees by the Issuers in the publication of the effects of which are long term debt such as bonds or sukuk.

PROHIBITION OF TRUSTEES

Trustees are prohibited from having a relationship with the Affiliate unless the Affiliate relationship Issuers occurs because the ownership or the inclusion of capital the Government, it is intended to avoid conflicts of interest between the Trustees as representative of the holder of the securities are debt or sukuk and interests of Issuers where Trustees have Affiliate relationships.

Trustees are also prohibited from having a relationship with the Credit Issuers except in accordance with the provisions of Bapepam-LK. It is intended to avoid conflicts of interest between the Trustees as representative of the holder of the securities are debt or sukuk and the interests of the Trustees as creditor or debtor of Issuers. This provision aims to Trustees can carry out its functions independently so as to protect the interests of holders of securities are debt or sukuk to its full potential.

Trustees banned doubles as the Ministers responsible in emission effect is the same debt or sukuk. The ban is intended to avoid conflicts of interest of Trustees as representative of the holder of the securities are debt or sukuk with the interests of the Trustees as the person who is obliged to meet the obligations of Issuers of debt securities holders are in the case of sukuk in wanprestasi by Issuers

DUTIES OF TRUSTEES

i. the Trustees must make contract perwalian manatan with the Issuer in accordance with the conditions set out by Bapepam-LK.

ii. the Trustees must provide compensation to the holders of securities are debt or sukuk for losses due to kelalaiannya in the execution of his duties as set forth in the legislation and its implementation as well as a contract or regulation perwalian manatan.

iii. Once registered on the Bapepam-LK Trustees must meet obligations as set forth in regulations of Bapepam-LK Chairman regarding the report of the Trustees and the obligation of storage of documents by the Trustees.

Obtained Bapepam guidelines regarding bond trustee agreement, in Bahasa only.

2. Trade protection
The Indonesia Central Counterparty (KPEI) guarantees the settlement of trades executed through the stock exchange. Over the counter (OTC) trades are not guaranteed. Investors are encouraged to open Sub Accounts at the Central Depository through Custodian Banks or Securities Companies for identification and protection of their assets.

3. Investor protection fund

The Capital Market and Financial Institution Supervisory Agency (Bapepam-LK) is planning to establish an investor protection fund. Unlike the guarantee fund which is managed by KPEI with the purpose to protect against settlement failure, the investor protection fund would provide protection against the risks of insolvency and fraud of the securities company for the investor’s securities safe kept with the securities companies.

K. Governing Laws of Bond issuance

Bonds issued by the Indonesian company or the Government of Indonesia offers in Indonesia through public offering and listed on the Indonesia Stock Exchange shall be governed by the laws of Republic of Indonesia.

1. UU Nomor 24 Tahun 2002 tentang Surat Utang Negara
2. UU Nomor 19 Tahun 2008 tentang Surat Berharga Syariah Negara
3. PP Nomor 56 Tahun 2008 tentang Perusahaan Penerbit Surat Berharga Syariah Negara
4. PP Nomor 57 Tahun 2008 tentang Pendirian Perusahaan Penerbit Surat Berharga Syariah Negara Indonesia
5. PMK Nomor 152/PMK.08/2008 Penerbitan Surat Berharga Syariah Negara dalam Valuta Asing di Pasar Perdana Internasional
7. PMK Nomor 75/PMK.08/2009 tentang Penerbitan Dan Penjualan Surat Berharga Syariah Negara Dengan Cara Penempatan Langsung (Private Placement)
9. Peraturan Bapepam dan LK Nomor IX.A.1: Ketentuan Umum Pengajuan Pernyataan Pendaftaran
11. Peraturan Bapepam dan LK nomor IX.C.1: Pedoman Mengenai Bentuk Dan Isi Pernyataan Pendaftaran Dalam Rangka Penawaran Umum
12. Peraturan Bapepam dan LK nomor IX.A.8: Prospektus Awal Dan Info Memo

L. Transfers of interests in bonds

Generally speaking, for scripless securities, transfer of entitlement and ownership of securities considered as completed, if the related transaction status in CSD's system reflected as "settled" and in the case of receipt transaction, the holding status of the
respective scripless securities in securities account maintained in CSD reflected as "available."
The third party entitlement will be ensured by showing the holding position in the Accounts maintained with CSD or holding confirmation issued by CSD.

1. KSEI for Dematerialised Shares, Corporate Bonds, PN’s and MTN’s

As far as Dematerialised Shares, Corporate Bonds, PN’s and MTN’s are concerned, the Indonesian Central Securities Depository (KSEI) maintains records of investor’s assets in electronic book-entry system as domestic CSD.

Securities transferred on the depository system are automatically registered without any additional documentation.

In the books of the issuers, the securities stand registered in the names of the account holders maintained in the depository.

The issuers receive regular update on the bondholders’ list from KSEI for their scripless securities whilst maintain the administration of physical securities. These physical securities are registered under the name of the securities holders.

2. BI for Dematerialised Government Bonds and SBI

Bank Indonesia (BI) as the Central Registry for Government Bonds and Certificate of Bank Indonesia (SBI) maintains an electronic registration of the sub-registry’s positions and each sub-registry in turn maintains the account details of each beneficial owner.

Sertifikat Bank Indonesia (SBIs) is normally settled on T+1, while for government bonds, the settlement cycle in the secondary market is either as agreed between parties involved or T+3.

Settlement of government bonds and SBI is through BI’s Scripless Securities Settlement System (BI-SSSS), a system to facilitate on-line settlement transactions between the sub-registries.

3. Physical corporate bonds

Most of the physical corporate bonds are in bearer form therefore registration is not required.

4. Settlement of scripless Corporate Bonds / Medium Term Notes / Promissory Notes:

Listed corporate bonds / MTN’s / PN’s settle according to the same general protocol as equities in the OTC market.
Unlisted bonds can be settled in scripless form as long as it is registered with KSEI.

5. Overseas connectivity: Euroclear is sub-registry of BI; SGX/CDP is using domestic custodian to access ID market; no foreign participation (=direct access) at KSEI by law.

M. Definition of securities
Definition of securities is not confined to a single law. Original relevant definitions found in the commercial code left by the Dutch, and remaining in force:

1. Promissory note (PN)
2. Cheque
3. Bill of exchange

No mention of corporate bonds and debt instruments in the Company Law; however, they are often described/covered in Articles of Association of companies.

Clearest definition of securities can be found in Capital Market Law No. 8 (1995). Pursuant to Indonesian Law No. 8 Year 1995 concerning Capital Market ("Capital Market Law"), Securities are promissory notes, commercial paper, shares, bonds, evidences of indebtedness, Participation Units of collective investment contracts, futures contracts related to Securities, and all derivatives of Securities.

Pursuant to the Elucidation of Capital Market Law, "Derivatives" refers to rights that are derived from either debt or equity Securities, such as Options or Warrants. An "Option" is the right to purchase or sell within a certain time, a specified number of Securities at a specified price. A "Warrant" is a Security issued by a Company giving the holder the right, six months or more after the Securities are issued, to subscribe to shares of the Company at a specified price.

Today, debt instruments distinction can be divided into capital market and money market: (1) Capital market covers bonds, (2) Money market cover PN, MTN, CP, SBI; most instruments have been introduced by foreign bank participants over many recent years.

MTN and CP are synonymous for all intents and purposes; legal treatises exist but no statutory definition of these instruments. MTN/CP issuer can choose KSEI as depository, but not mandatory. Commercial bills exist, under freedom of contract provisions; used by non-bank issuers; for bank issues, relevant banking provisions apply.

N. Self-Governing Rules behind the Market

The following entities are Self-Regulatory Organisations (SRO):

1. The Indonesia Stock Exchange (IDX)
2. The Indonesian Central Counterparty (KPEI)
3. The Indonesian Central Securities Depository (KSEI)

Each regulates its own areas of operations, subject to Bapepam-LK approval.

A number of market associations exist, but none has SRO status.

IDX

IDX has been formed as a result of the merger between the Jakarta Stock Exchange (JSX) and Surabaya Stock Exchange (SSX) on November 30, 2007. IDX is a private stock exchange company.
IDX is regulated by the Bapepam-LK and the Ministry of Finance. All stock exchange regulations are issued by the Bapepam-LK based on Ministry of Finance decrees.

Before merger, JSX (Jakarta Stock exchange) was a private stock exchange company since 1991. JSX took over the management of the previous exchange from Bapepam-LK. SSX (Surabaya stock exchange) was established in 1989 as the first private stock exchange in the country. It was located in Surabaya, the second largest city of Indonesia. SSX was established to support the Indonesian government’s program of improving the capital market in Eastern Indonesia.

On July 22, 1995 the SSX was merged with the Indonesian Parallel Stock Exchange (IPSX), leaving only two primary exchanges in Indonesia, the SSX and the Jakarta Stock Exchange (JSX).

On 30th November, both these remaining stock exchanges merged to form IDX which is now the only existing stock exchange in Indonesia.

Self-Governing Rules

Peraturan Himdasun: Peraturan No.1 Keanggotaan Perhimpunan Pedagang Surat Utang Negara.
Peraturan Himdasun No.1 Keanggotaan Perhimpunan Pedagang Surat Utang Negara.
Peraturan Himdasun No.III Pengawasan Perdagangan Surat Utang Negara,
Kode Etik Himdasun, dan Master Repurchase Agreement.

Market Associations

There are two bond market associations in Indonesia: the Inter-Dealer Market Association for Government Securities (HIMDASUN) and the Indonesian Fixed-Income Dealer Association.

1. The Inter-Dealer Market Association for Government Securities (HIMDASUN)

HIMDASUN has 26 members comprising domestic and foreign banks, and securities companies.

2. The Indonesian Fixed-Income Dealer Association

O. Bankruptcy Procedures

Issuer, that failure or inability to fulfill its obligations towards non-affiliation creditor, have to submit report concerning its condition to both Bapepam-LK and Stock Exchange where Issuer’s securities listed as soon as possible, no later than last of second working day since the Issuer has failed or not able to avoid failure to fulfill its obligations.

According to Peraturan Bapepam dan LK Nomor X.K.5: Keterbukaan Informasi Bagi Emiten Atau Perusahaan Publik Yang Dimohonkan Pernyataan Pailit, the report have to encompass as following details about loan including the amount of principal and interest, loan terms, name of the creditors, the use of loan and reasons for the failure or inability to avoid failure.

UU Nomor 37 Tahun 2004 tentang Kepailitan Dan Penundaan Kewajiban Pembayaran Utang stated requirements dan decision of bankruptcy with the following conditions:
1. Debtor has two or more creditor and unable to fulfill its obligations at least one debt on maturity date and payable,

2. Debtor has been declares bankrupt by cout decisions, either on self application or the request of one or more creditors

In terms of issuer filled with the court requested for bankruptcy petition, issuer have to submit report concerning referred request to the court to Bapepam-LK and also to Stock Exchange where Issuer’s securities listed as soon as possible, no later than last of second working day since the issuer knows the existence of bankruptcy petition.

Party as set in article 85 of Capital Market Law, that request for bankruptcy petition to the court towards issuer, has to report it to Bapepam-LK and Stock Exchange where Issuer’s securities listed as soon as possible, no later than last of second working day since the date of referred request.

The Stock Exchange shall publish the information about Issuer or Public Company that being requested to the court for bankruptcy petition within the same day with the receipt of information.

In case debtors are banks, bankruptcy petition only could be requested by Bank Indonesia.

In case debtors are Securities Company, Stock Exchange, CDD and CSD, only Bapepam-LK could request for bankruptcy petition.

And if debtors are Insurance Company, Reinsurance Company, Pensin Funds, or State-Owned Enterprises involved in public interest, only Minister of Finance could request for bankruptcy petition.

To represents the interests of EBU’s holding, Trustee has duty both inside and outside court as stipulated in Trustee Contract and Peraturan Bapepam dan LK Nomor VI.C.4: Ketentuan Umum Dan Kontrak Perwaliamanatan Efek Bersifat Utang.

Since the sign of Trustee Contract until the end of Trustee’s duties, Tustee is prohibited from receiving and requesting advance payment of issuer’s obligation to Trustee as creditor in case of issuer have financial difficulties based on Trustee’s consideration.

Trustee Contract with issuer shall be made by the Trustee in order to protect and represent EBU’s holding rights.

The contract also contains concerning failure condition in case issuer unable to perform or disobeyed provisions in the Trustee Contract, including one obligation of principal payment and/or EBU interest on maturity date.

The contract also regulates concerning settlement procedures in failure condition and the authority of trustee in pointing Capital Market Supporting Professionals to assist the investigation in case any differences in understanding in failure condition.

Any expense arising on such appointment become burden for Issuer.

*Examples of other points of consideration
1. Degree of Opening of Domestic Bond Markets to Foreign Investors

Current regulatory arrangement does not require Foreign Investor to register when entering the Indonesian domestic market.

2. Degree of Opening of Domestic Bond Markets to Foreign Issuers

Under current regulatory arrangement, if bond issuance by non residents is publicly offered, it must follow the similar procedures with the issuance by domestic firms without any exception. It hinders the foreign issuers due to especially the requirements on domestic supporting professionals

P. Meetings of bondholders

The issuer is responsible for the resolution, based on the general meeting of bond holders' resolution.

Q. Event of default

The event of default is related to the issuer of the bonds.

As far as “who recognize and who declare the event of default” is concerned, the prevailing regulations are silent on this, and it will refer to the mutual agreement of the parties stated in the trust agreement.

Pursuant to prevailing Bapepam-LK Regulation, the trust agreement to be entered into by the trustee (wali amanat) and the issuer shall at least have the following provision to be classified as “event of default.”

1. The issuer does not meet its financial obligation for principal repayment and/or interest payment when it is due;

2. The collateral granted by the issuer or the issuer status and conditions and their management in fact are not in line with the representation or statement made by the Issuer (misrepresentation);

3. The issuer has been declared default in relation to credit agreement by one or more of its creditor (cross default);
   I.E. Cross-default is possible, clauses are used in contracts; grace periods may apply.

4. Suspension of payment (moratorium) of the issuer is declared, and;

5. The issuer does not perform its other obligations stated in the trust agreement.

There were several cases of default of bonds and commercial papers, especially during the monetary crisis in Indonesia on 1997-1998.

R. Bankruptcy Law and related Rules

The Indonesian Bankruptcy Law provides the legal infrastructure for bankruptcy, which can be settled either through court proceedings or informal mechanisms.
Creditors may file a bankruptcy petition or submit a lawsuit to the relevant district court based on a breach of contract. During the 1997 Asian financial crisis, the Government established the following informal mechanisms to facilitate negotiations between debtors and creditors:

1. The Jakarta Initiative Task Force to provide corporate debt restructuring and workout plans to both creditors and debtors.

2. The Indonesian Debt Restructuring Agency to help market-oriented corporations resolve their debt by providing them with fixed exchange rates to strengthen the value of the rupiah. This agency’s mandate expired in 2006.

3. The Indonesian Bank Restructuring Agency to facilitate bank and loan restructuring by taking over a bank’s non-performing loans and injecting new funds to recapitalize them.

Provisions for insolvency are also included in the Capital Market and Financial Institution Supervisory Board (BAPEPAM-LK) Rulebook.

http://www.insolvencyasia.com/insolvency_law_regimes/indonesia/section_i.html
http://www.baepam.go.id/old/old/e_legal/rules/issuer/XK5.pdf

S. Established principles and standards

1. Corporate Governance

The Indonesian Company Law of 1995 established the legislative framework for corporate governance in Indonesia. In August 1999, the National Committee for Corporate Governance was created to develop best-practice guidelines and a code of corporate governance.

IDX also implemented corporate governance regulations for publicly-listed companies, including reporting standards.

Related Resources:

Codes and Rules on Corporate Governance for Indonesia
http://www.acga-asia.org/content.cfm?SITE_CONTENT_TYPE_ID=12&COUNTRY_ID=265

The Corporate Governance of Listed Companies: A Manual for Investors
http://www.gmiratings.com/noteworthy/CFA_14_05.pdf

2. Contracts Law

The statutory basis governing all private transactions is the civil code. An English language translation of the Indonesian Civil Code and a summary of relevant contract law can be found by following the links below.

3. Ethics
The Capital Market Law (Law 8/1995) provides the basis for proper market practices in Indonesia. It also identifies violations, including fraud in buying and selling securities (Article 90); market manipulation (Articles 91–2); and insider trading (Articles 95–8).

BAPEPAM-LK is responsible for the guidance, regulation, and supervision of Indonesian capital markets under Article 3.1 of the Capital Market Law. BAPEPAM-LK has the authority to license and issue rules for market participants, including rules on codes of conduct.

Linked below are BAPEPAM-LK rules in relation to ethical market practices, including: (i) Code of Conduct for Securities Companies Acting as Broker Dealers, (ii) Code of Conduct for Securities Companies Acting as Underwriters, (iii) Prohibited Investment Advisors Conduct, and (iv) Prohibited Investment Manager Conduct.

Related Resources:

Code of Conduct for Securities Companies Acting as Broker Dealers

Code of Conduct for Securities Companies Acting as Underwriters

Prohibited Investment Advisor Conduct

Prohibited Investment Manager Conduct

T. Parties involved in a bond issue and their respective roles

1. Issuers

The Government, which is the dominant issuer of bonds in Indonesia, authorizes Ministry of Finance (MOF) treasury instruments and Sertifikat Bank Indonesia (SBI). Corporate sector issuers comprise a small percentage of the bond market, representing less than 10% of total bonds outstanding as of December 2008.

a. Government

The Government is the principal issuer in the debt market through the regular issuance of treasury bonds and treasury bills by the Ministry of Finance (MOF). Government bonds listed on the Indonesia Stock Exchange (IDX) can be found through the link provided below. BI also issues Sertifikat Bank Indonesia (SBI), which are short-term bank certificates.

To improve market liquidity and provide better access for foreign and retail investors, the MOF offered its first ever 3-year retail bonds on 17 July 2006. Government retail bonds are bonds with a required minimum purchase of only IDR5 million, compared with the normal government bond minimum of IDR1 billion.

The Government has issued international bonds since 2004, when it initially tapped the global market for USD1 billion. Two subsequent bond issues in 2005 totaled USD2.5 billion. In June 2008, the Government issued its largest single international...
bond to raise USD2.2 billion, following issuance of USD2.0 billion in the first quarter of 2008. More recently, the government issued USD3 billion of international bonds in February 2009, bringing its total stock of international bonds to USD14.2 billion.

b. Corporate

Corporate issuers re-entered the domestic and global debt market five years after the 1997 Asian financial crisis. PT Medco Energi Internasional, a private oil company, issued USD bonds in 2002, which paved the way for other private corporations to follow suit.

Corporate issuers have issued either conventional bonds or Islamic sukuk bonds. A list of corporate bond issuers can be found by following the link provided below.

2. Investors

Banks are the major holders of government bonds, with ownership totaling IDR259 trillion as of December 2008, which represents nearly 50% of all government bonds. Other investors include asset-pooling industries (e.g., mutual funds, pension funds, and insurance companies), and private investors.

Outbound investment: Mutual funds may only invest upto 15% or 30% (capital protected MF) of NAV overseas – in assets ‘on an exchange or market that can be accessed by mass media’; restrictions are found in both Bapepam regulations/guidelines and the mutual fund’s specific constituting documents.

Pension funds cannot invest overseas; insurance have to follow prudential regulations.

Holding of, and payment in, foreign currency is permitted.

a. General Investors

Domestic financial institutions dominate the debt market. Other investors include mutual funds, pension funds, foreign financial institutions, insurance companies, and individuals. A breakdown of government bond ownership can be found by following the link below.

Generally, there are no restrictions on foreign investors owning Indonesian government or corporate bonds.

Related Resources:
Investor Profile (In Bahasa Indonesia)
http://www.dmo.or.id/dmodata/5Statistik/6Kepemilikan_SUN_yang_dapat_Diperdagangkan/Kepemilikan_SUN_yang_Dapat_Diperdagangkan.pdf

b. Asset-Pooling Industries

Pension Funds

Two types of state funds dominate the pension fund industry in Indonesia: Jamsostek for non-government workers and Taspen for civil servants.
Insurance Companies

Indonesia’s insurance industry is fairly small, but it has been growing steadily since 2000. Insurance companies are important institutional investors in Indonesia’s capital market. In 2008, the insurance industry held about 11% of all tradable government bonds.

Mutual Funds

Indonesia’s managed-fund industry has grown considerably since 2000. However, in 2005 the Capital Market and Financial Institution Supervisory Board (BAPEPAM-LK) issued new regulations requiring fixed-income funds to be valued using a mark-to-market system rather than on a cost-accrual basis. This requirement led to a decrease in the value of fixed-income funds. As a result, investors withdrew significant amounts of money from fixed-income mutual funds, which negatively impacted the market. In October 2005, investment in fixed-income securities with maturities greater than one year was restricted by BAPEPAM-LK.

Fixed-income assets comprised a considerable portion of investment-fund assets prior to 2005. After the near collapse of the industry, BAPEPAM-LK allowed fund managers to introduce protected mutual funds. Protected mutual funds are not risk-free, but they offer a form of guarantee of a return equal to the initial investment.

As of June 2008, the net asset value of mutual funds was at IDR94 trillion.

Related Resources:
Financial Stability Review (September 2008)

3. Intermediaries

Securities companies:

Securities companies in Indonesia may act as broker-dealers, underwriters, and investment managers.

The Capital Market and Financial Institution Supervisory Board (BAPEPAM-LK) provides a comprehensive list of companies and individuals who are licensed broker-dealers, advisers, custodians, transfer agents, investment managers, and underwriters.

IDX:

The Indonesia Stock Exchange (IDX) provides a list of member brokers and participants in its fixed-income trading system and centralized trading platform.

Related Resources:

BAPEPAM-LK List of Custodians and Share Registrars (In Bahasa Indonesia)
http://www.bapepam.go.id/pasar_modal/data_pm/lembaga_penunjang.htm

U. Major Players in the Market
Participants in the Indonesian bond market include issuers from the Government and the corporate sector; supranational and offshore borrowers; investors comprising financial institutions and asset-pooling industries; intermediaries comprising securities companies, investment houses, and dealers; rating agencies; and market associations.

As the largest issuer of bonds, the Government of Indonesia regularly taps the local market to finance the state budget. Bank Indonesia (BI) also issues short-term bank certificates known as Sertifikat Bank Indonesia (SBI).

Corporate bond activities, including conventional and Islamic bond offerings, accelerated significantly beginning in 2003 and have maintained momentum since then. Islamic bonds, which are based on shari’a principles, play a major role in Indonesian capital markets. In April 2008, the Islamic Shari’a Debt Bill was passed into law to enable the Government to issue Islamic bonds.
II. Primary and secondary market regulatory frameworks

A. Indonesia market Regulatory Structure

In general, rules and regulations for the bond market are governed by the Ministry of Finance (MOF). Several regulatory agencies are also involved. Details on the specific functions of these agencies are discussed in this section.

1. Market Entry Requirements

Foreign Investors are free to invest in the Indonesian market. No approval/registration is required by the non-resident investors for investing into Indonesia. Foreign and local investors are treated at par and the same investment regulations apply to all classes of investors.

2. Market Regulators

a. MOF:

The Ministry of Finance, Government of Indonesia, is the apex body responsible for the administration of finances of the Central Government and for all economic and financial matters affecting the country.

b. BI:

Bank Indonesia (BI) is the central bank of Indonesia. It became an independent central bank with the enactment of The Central Bank Act, the UU No. 23/1999 on May 17, 1999. The Act confers on it the status and position of an independent state institution without any intervention from the Government or any other external parties. BI is fully autonomous and has the authority to formulate and implement regulations as stipulated in the Act.

BI is responsible for:

i. Maintaining stability of the Rupiah (IDR)
ii. Monetary policy
iii. Payment system
iv. Regulating and supervising the banking system

BI also acts as the central depository for the settlement and safekeeping of government bonds and certificate of Bank Indonesia (locally known as Sertifikat Bank Indonesia or SBI).

c. Bapepam-LK:

The Capital Market and Financial Institution Supervisory Agency, locally known as Badan Pengawas Pasar Modal dan Lembaga Keuangan (Bapepam-LK), is a division of the Ministry of Finance that regulates and supervises the capital market and non-bank financial services sector.

Bapepam-LK was formed as a result of a merger between the Capital Market Supervisory Agency (Bapepam) and the Directorate General of Financial Institution...
(DJLK). The merger took place in January 2006.

However, regulatory supervision still effectively done with BI; both entities expect the transfer of supervisory functions to be completed in the near future.

This regulatory body is responsible for regulating all capital market players, including insurance, pension funds and other non-bank financial services.

It is also the authority that registers and grants licences to various securities market intermediaries (e.g. brokers, mutual funds, custodian banks, underwriters etc).

Bapepam-LK has power to declare/define new/other instruments.

All securities >1 year tenure included in Capital Market, hence Bapepam+LK coverage.
All instruments <1 year tenure also considered securities but not under Bapepam-LK coverage.
Money market instruments are governed by BI.

Private placements do not require Bapapem's involvement; clear supervisory function does not exist, no specific regulation in evidence.
Public placements are defined as >50 buyers/participants.
Key criteria for public offering is public (domain) advertising.
If public placements meet official criteria – governed by Bapapem; exceptions are MTN (normally done via private placement) and government bonds.
CP seem to be included under MTN definition and treatment; MTN settlement and depository is done at KSEI.

Secondary market coverage:

i. On exchange – governed by Bapepam.
ii. OTC – outside of Bapepam coverage.

Law number 8 Year 1995 related to the Capital Market (UUPM)

The main reference for current operation of the capital market is Law number 8 Year 1995 related to the Capital Market (UUPM).

Article 3 of the Minister of Finance Decree No: 503/KMK.01/1997 details the functions of Bapepam-LK:

i. Prescribing Capital Market rules and regulations
ii. Ensuring the compliance toward Capital Market rules among market players
iii. Formulating disclosure requirements for the Issuers and Public Companies
iv. Guiding and supervising any Person granted business license, approval, registration from Bapepam-LK and other Person related to Capital Market
v. Settling and re-dressing of disputes of person(s) on whom sanctions have been imposed by the Stock Exchange, Clearing Guarantee Corporation or the Central Securities Depository
vi. Establishing Capital Market accounting standards

Bapepam-LK has the authority to grant:
i. Licenses  
ii. Approvals  
iii. Effective registrations to capital market participants  

d. Self-Regulatory Organisations (SRO):  
i. The Indonesia Stock Exchange (IDX)  
ii. The Indonesian Central Counterparty (KPEI)  
iii. The Indonesian Central Securities Depository (KSEI)  

Each regulates its own areas of operations, subject to Bapepam-LK approval  

3. Capital Market Regulations  

The key legislation in the Indonesian Market is the Law No.8/1995 on the Capital Market.  

According to Law No:8/1995 of the Republic of Indonesia; guidance, regulation, and day-to-day supervision of capital market is to be provided by Bapepam-LK.  

It is Bapepam-LK’s responsibility to ensure an orderly, fair and efficient capital market and protect the interests of the investors and public.  

The Capital Market Law regulates the following:  

a. Bapepam-LK  
b. Stock Exchange, KPEI & KSEI  
c. Mutual Funds  
d. Brokerage Firm & Investment Manager Companies  
e. Capital Market Supporting Institutions  
f. Settlement of Bourse Transaction  
g. Capital Market Supporting Professions  
h. Issuing and Public Companies  
i. Reporting and Disclosure of Information  
j. Fraud and Insider Trading  
k. Audit  
l. Investigation  
m. Sanctions  

4. Investment Restrictions  

There are currently no general restrictions on foreign investment in the Indonesian securities market except the following:  

a. Foreign investors may hold a maximum of 99%* of the total capital of a local bank, as at least 1 percent of the bank’s total capital must be owned by an Indonesian entity(s)  
b. Foreign ownership in the broadcasting companies is permitted up to 20% of the issued share capital.  

*Investors must obtain Bank Indonesia approval prior to executing any purchase of local bank shares that would affect the control of the local bank or exceed 25 percent of the local bank’s total issued shares. (This regulation applies to both direct and indirect investments in local banks).
5. Ownership Disclosure Requirements

a. Ownership of 5 percent or more:
   Shareholders with ownership of 5 percent or more are required to submit a
disclosure report to Bapepam-LK.
   This report must be submitted within 10 days subsequent to the date on which the
share ownership limit was reached.

b. 50 percent ownership:
   The threshold for tender offer has been increased, from 25 to 50% of total
company’s shares. The stock exchanges monitor these limits based on reports
from investors, local registrars and from local brokers for exchange transactions.

6. Regulation on Structured Products

Bank Indonesia (BI) enacted a new regulation No. 11/26/PBI/2009 on Prudence
Banking for Banking Activities Involving Structured Products.

The salient points of the regulation are as follow:

a. Structured products are defined as commercial bank products that combine two or
more non derivative instrument with derivative instrument or derivative with
derivative instruments with the following characteristics:

i. The value or cash flow on the product is tied to one or more underlying
variable factors, such as interest rate, exchange rate, commodity rate, and/or
equity price.
ii. The cash flow’s movement does not directly relate to the changes of the
underlying variable factors, causing asymmetric payoff.
   Such arrangement is usually coupled with the below features in the product:
   a) Option term i.e., caps, floors, collars, step up / step down, and or call / put
      features
   b) Leverage
   c) Barriers i.e., knock in or knock out
   d) Binary or digital ranges

b. Structured product process is determined as activities and / or the whole process
of planning, developing, issuance, marketing, supplying, selling, operating, and /
or terminating structured products.

c. Commercial banks can only start the process on structured products after
obtaining approval and effective statement from Bank Indonesia, for each
structure product

d. For structure product with combination of two or more derivative instruments,
commercial bank is required to do the following:

i. To request their clients to maintain a cash collateral for at least 10 percent
from the total of customer’s notional value of the transaction. This
arrangement has to be reflected in a written contract between the bank and
the customer.
ii. Exceptions to point (a) above are given to the following customer type:
a) Bank  
b) Indonesia government  
c) Bank Indonesia or other central bank  
d) Bank or multilateral development organization  

e. Commercial bank is required to implement risk management on structured products process. The risk management policy needs to cover:  

   i. Active supervision of bank’s board of commission and management.  
   ii. Adequate internal policy and procedure  
   iii. Adequate identification process, measurement, supervision on risk control and management information on risk.  
   iv. Internal control system  

f. Commercial bank is required to classify their customer on structured product activity. The classification have to cover:  

   i. Professional customer  
   ii. Eligible customer  
   iii. Retail customer  

g. Commercial bank is required to implement transparency towards customers, on each process of marketing, offering, and settlement of structured products.  

h. Commercial bank is required to submit report on their structured product transactions to Bank Indonesia every month, at the on the 10th of each month.  

i. Breaches of the terms of this regulation are subject to the sanction imposed by Bank Indonesia including:  

   i. Warning letter  
   ii. Downgrading of the bank’s credibility  
   iii. Prohibition on of the bank clearing activity,  
   iv. Freezing and revocation of effective statement on certain business activities.  
   v. Termination of bank’s management  
   vi. Inclusion of the bank’s management, employees, and shareholder into Bank Indonesia’s blacklist.  

j. Transitional rules:  

   i. Structured products that were issued prior to the issuance of this regulation are still required to obtain effective letter from Bank Indonesia  
   ii. Structured products that were issued prior to the issuance of this regulation can be administered until their maturities.  

This regulation is effective since July 1, 2009.  

B. Disclosure requirements (filing, prospectus, etc.)  

A Prospectus has to cover all details and material facts concerning IPO done by issuer, that could affect investors’ decisions, which already known or has to been known by the Issuer and Underwriter (if any).
A Prospectus have to be made in such a way with the result that be clear and communicative. Facts and considerations that most important shall be summarized and disclosed at the beginning of the Prospectus.

The sequence of the facts in the prospectus is determined by their relevance to the facts of a particular problem, not in accordance to Peraturan Bapepam dan LK Nomor IX.C.2 tentang Pedoman Mengenai Bentuk Dan Isi Prospektus Dalam Rangka Penawaran Umum.

The issuer have to be carefull when using images, diagrams, or tables in the prospectus, as these materials could give a misleading impression to public. Issuer shall also maintain so that the delivery of important information is not obscured by less important information that lead to important information regardless of the reader's attention.

Issuers have to make adjustment to the disclosure of material facts carried out with emphasis cleary relevant to their business or industru sector, with the result that a Prospectus not mislead. Issuers, Underwriters and Capital Market Supporting Professionals are responsible to determine and disclose reffered facts in a clear and readable.

In a IPO of EBU, a Prospectus contains information regarding:

1. Date of maturity,
2. Interest rates,
3. Interest payment dates,
4. Execution for early redemption,
5. Conversion rights,
6. Warant,
7. Trustee’s full name,
8. Underwriter’s full name (if any) and
9. Rating result from Credit Rating Agency.

In addition, a Propectus at least disclose relevant information :

1. IPO,
2. The use of funds obtained from IPO,
3. Statement of Debt,
4. Management’s Discussion and Analysis,
5. Business risks,
6. Important Events Following Auditor’s Report Dated,
7. Informations Concerning Issuer,
8. Activities And Prospects of The Issuer,
9. Financial Highlights,
10. Equity,
11. Dividend Policy,
12. Taxation,
13. Underwriter,
14. Capital Market Supporting Professionals,
15. Legal Opinion,
16. Financial Reports,
17. Appraisal Report (if any),
18. Charter,
19. Requirements of Securities’ Subscription,
20. Distribution of Prospectus and dan Securities’ Subscription Form,
21. Trustee and Underwriters.

For medium or small company that submit a Registration Statement and build prospectus addressed to IPO based on Peraturan Bapepam dan LK Nomor IX.C.7 tentang Pedoman Bentuk dan Isi Pernyataan Pendaftaran Dalam Rangka Penawaran Umum Oleh Perusahaan Menengah Atau Kecil and Nomor IX.C.8 tentang Pedoman Mengenai Bentuk dan Isi Prospektus Dalam Rangka Penawaran Umum Oleh Perusahaan Menengah Atau Kecil.

C. Credit rating requirements

Issuer who will issue EBU should obtain rating of referred EBU from Credit Rating Agency (CRA), based on Peraturan Bapepam dan LK nomor IX.C.11: Pemeringkatan EBU. Issuer have to hold a business license from Bapepam and LK based on Peraturan Nomor V.C.2: Perizinan Perusahaan Pemeringkat Efek.

Rating is an opinion from CRA concerning ability of parties who rated to meet payment obligations in a timely manner (company rating) and/or related to the securities issued by referred parties (instrument rating). Ratings could be done to:

1. EBU, Sukuk, Asset Backed Securities or other rated securities;
2. Party as an entity, including Mutual Funds and Real Estate Investment Trust in form of Collective Investment Contract.

D. Exemptions for private issues (private placement)

IPO which (1) offer to less than 100 (hundred) Parties or (2) has been sold to less 50 (fifty) Parties in certain limit value and time limit, exempted from the obligation to deliver the Registration Statement to Bapepam-LK to offer or sell securities to the public.

E. Minimum lead time (number of business days) for registration approval

A Registration Statement becomes effective within 45 (forty five) days since the date of receipt by Bapepam and LK completely, or since the date of final amendment delivered by issuer or requested by Bapepam-LK.

F. Availability of shelf registration and associated documentation requirements

There is a rule related to Sustainable Public Offering (Shelf Registration) based on Peraturan Bapepam dan LK Nomor IX.A.15: Penawaran Umum Berkelanjutan, which allows the EBU issued to the public in several stages. Issuer have to submit Registration Statement in order Sustainable Public Offering with following requirements:

1. In accordance with Peraturan Bapepam dan LK Nomor IX.A.1, IX.A.2, IX.C.1, IX.C.2 and other related regulations.
2. Equipped with statement from issuer or Public Company and Accountant which stated that referred issuer or Public Company never experienced Failure to Pay for a certain period.
Moreover, issuers also have to submit reports and information as follows:

1. Report of Sustainable Public Offering result to Bapepam-LK at least 5 (five) working days following the date of allotment
2. Information of reasons for not achieving the target funds (if target acquisition funds are not met)
3. Additional information and supporting documents when issuer going to issue on the second and subsequent stages, at least 2 (two) days since the announceent of additional information.

G. Regulated suspension period (this may relates to investor protection)

Under Peraturan Bapepam dan LK Nomor IX.A.2: Tata Cara Pendaftaran Dalam Rangka Penawaran Umum, in the period from the effective of Registration Statement up to the expiration of IPO, Issuer could postpone the IPO for the period of maximum 3 (three) months since the effective of Registration Statement or cancel the IPO, with provisions:

1. Occurance to circumstances beyond the ability and power Issuer which covers:
   a. the decrease of Stock Exchange Composite Index exceeding 10% (ten percent) for 3 (three) consecutive trading days;
   b. Natural disasters, war, civil commotion, fire, strike which significantly influence the survival of the Issuer; and/or
   c. other events which significantly influence the survival of the Issuer specified by Bapepam and LK based on Formulir Nomor: IX.A.2-11 lampiran 11; and

2. Issuer have to comply requirements as follows:
   a. publish IPO postponement or IPO cancellation at least one Indonesian language newspaper which has a national circulation no later than one working day following the referred postponement or cancellation. In addition, Issuer could also publish referred information in other mass media;
   b. submit information concerning period of IPO postponement or IPO cancellation pembatalan to Bapepam and LK on the same day as the publication;
   c. submit the evidence of publication to Bapepam and LK at least one working day following the publication; dan
   d. Issuer which postpone it's period of IPO or cancel the ongoing IPO, in terms of securities orders have already been paid, should refund the money subscriber securities to the subscribers no later 2 (two) working days since decision of postponement or cancelation.

3. Issuer which makes postponement or cancelation and would restart the period of IPO following provisions apply:
   a. in terms of the cancellation of IPO period caused by the decrease of Stock Exchange Composite Index, then issuer have to restart the period of IPO no later than 8 (eight) working day since Stock Exchange Composite Index increased at least 50% (fifty percent) from total of the referred decrease of Stock Exchange Composite Index;
   b. in terms of decrease of Stock Exchange Composite Index occurs longer, Issuer may postpone the period of IPO;
   c. have to submit to Bapepam and LK with the information concerning IPO
schedule and other additional information, including the information on material facts following the cancellation of IPO (if any) and publish it on at least one Indonesian language newspaper which has a national circulation no later than one working day prior to the recommencement of IPO period. Issuer could also add publication on other mass media; and
d. Have to submit the evidence of referred publication to Bapepam and LK no later than one working day following the publication.

H. Other requirements

Under Peraturan Bapepam dan LK Nomor IX.A.11: Penawaran Umum Efek Bersifat Utang Dalam Denominasi Mata Uang Selain Mata Uang Rupiah, the IPO of EBU denominated in currencies other than Rupiah have to in accordance with Bapepam and LK rules related to IPO. Additional information shall to be disclosed in Prospectus at least as followings:

1. quantity, value, and the period of EBU denominated in currencies other than Rupiah and the equality value in Rupiah during referred EBU are offered;
2. risks faced, among others related to difference rate and impact on the financial condition of issuer;
3. presence or absence of the hedge and potential benefits and cost associated with referred hedge;
4. presence or absence of the fund of debt repayment and overview of requirement concerning referred fund;
5. presence or absence of certain assets of Issuer which became collateral on debt that arise with respect to EBU offered; and
6. The earnings of Issuer both ini Rupiah and other currencies.

Underwriter or Issuer (in case there is no Underwriter) have to submit report concerning the quantity and the maturity date of the payment of principal and interest of EBU denominated in currencies other than Rupiah to Bapepam and LK and give copy to BI no later than 5 (five) working days following the date of allotment.


I. Continuous disclosure rules or requirements

Bapepam regulate further obligations for Issuer as follows:

1. Material Transaction (Bapepam Rules No. IX.E.2) Issuer which have Material Transaction with transaction value of 20% until 50% from it’s equity is not required to obtain approval from General Meeting of Shareholders (GMS), but have to according to Bapepam rules. Issuer which have Material Transaction with transaction value more than 50% from it’s equity, shall obtain approval from GMS according to Bapepam rules.
2. Core Business Changes (Bapepam Rules No. IX.E.2) Issuer which change it’s core business required to obtain prior approval from GMS.
3. Affiliated Transaction and Conflict of Interest on Certain Transaction (Bapepam Rules No. IX.E.1)
Issuer have to publish the disclosure of information on every Affiliated Transaction to public and submit the evidence together with related documents to Bapepam. Transaction with Conflict of Interest shall obtain prior approval from Independent Shareholders or their authorized representatives on GMS based on Bapepam rule. Those approvals shall be confirmed in the form of notarized deed.

4. Merger or Consolidation of Business (Bapepam Rules No. IX.G.1)
   The Director and Commissioner of Issuer which will have merger or consolidation of business shall make statement to Bapepam.

   Issuer shall submit to Bapepam related to Annual Report, Periodical financial report, the use of funds from IPO report, information concerning Issuer fails or unable to avoid the failure to pay its obligations to unaffiliated creditors, information concerning material fact which could affect the value of securities investor decisions.

J. Restrictions for investors (investment grade, etc.)

There are investment policy guideline of investors such as insurance and pension funds that is developed by the authority in order to manage the risk.

K. Definition of Qualified Institutional Investors, Professional Investors, if exist

N/A for the moment.

L. Non-resident requirements / restrictions

N/A

M. How to ensure market functions for the finding of Fair Price

The reporting based on Peraturan Bapepam dan LK Nomor X.M.3: Pelaporan Transaksi Efek aims to enhance development and integrity of EBU and Sukuk market via the reporting of securities trading. In the reporting procedures under exchange rules concerning the Reporting Of Securities Trading through Centralized Trading Platform Beneficiary of Securities Transaction Report (CTP-PLTE), participant who report via CTP-PLTE should enter data including the price of securities trading.

Furthermore, with the release of Peraturan Bapepam dan LK Nomor V.C.3 tentang Lembaga Penilai Harga Efek followed by the establishment of PT Penilaian Harga Efek Indonesia or Indonesian Bond Pricing Agency (IBPA), the investor could obtained reference of fair value. IBPA’s duties are to assign fair market price of EBU, Sukuk and other securities independetly.

N. Taxation Framework and Tax requirements

1. General Framework

Taxation arrangements divided on SPN and Bonds (both Government and Corporate). Peraturan Pemerintah (PP) Nomor 27 Tahun 2008 tentang Pajak Penghasilan Atas Diskonto Surat Perbendaharaan Negara and PMK Nomor 63/PMK.03/2008 tentang Tata cara Pemotongan Pajak Penghasilan Atas Diskonto SPN regulates the collection
of income tax which is final. The amount of income tax is:

a. 20% for the local tax payer and Fixed Business Form, and
b. 20% or based on tariff provisions on Peraturan Pemerintah Republik Indonesia Nomor 16 Tahun 2009 tentang Perpajakan Pajak Penghasilan Atas Bunga Obligasi (P3B) for tax payer resident/ domiciled abroad,

PP Nomor 16 Tahun 2009 tentang Pajak Penghasilan Atas Penghasilan Berupa Bunga Obligasi regulates taxation provisions of capital gain and interest of Bond. On income received and/or obtained by the tax payer in form of interest of Bond is subject to withholding of income tax which is final with amount:

a. Interest of Bond with coupon:
   1) 15% (fifteen percent) for local tax payer and Fixed Business Form; and
   2) 20% (twenty percent) or in accordance with tariff on P3B for foreign tax payer apart from Fixed Business Form,

   from the gross amount of interest in accordance with the period of Bond ownership;

b. Discount of Bond with coupon:
   1) 15% (fifty percent) for local tax payer and Fixed Business Form; and
   2) 20% (twenty percent) or in accordance with tariff on P3B for foreign tax payer apart from Fixed Business Form,

   from excess of selling price or nominal value over price of Bond’s acquisition, not include current interest;

c. Discount of no interest Bond:
   1) 15% (fifty percent) for local tax payer and Fixed Business Form; and
   2) 20% (twenty percent) or in accordance with tariff on P3B for foreign tax payer apart from Fixed Business Form,

   from excess of selling price or nominal value over price of Bond’s acquisition, not include current interest; and

d. Interest and/or discount of Bond received and/or obtained by the tax payer of Mutual Funds listed on Bapepam and LK:
   1) 0% (zero percent) for 2009 until 2010;
   2) 5% (five percent) for 2011 until 2013; and
   3) 15% (fifty percent) for 2014 and so on.

Corporate Bond and Government Bond or other Government Bond under one year which being traded or its trade of on Stock Exchange being reported is stipulated on PP Nomor 6 Tahun 2002 tentang Pajak Penghasilan Atas Bunga Dan Diskonto Obligasi Yang Diperdagangkan Dan/Atau Dilaporkan Perdagangannya di Bursa Efek. The amount of Income Tax is:

a. For interest bearing bond:
   1) 20% (twenty percent), for local tax payer and Fixed Business Form;
   2) 20% (twenty percent) or in accordance with tariff on P3B, for bagi for tax payer resident/ domiciled abroad;

   from the gross amount of interest based on holding period of Bond.

b. For Bond discount with coupon:
   1) 20% (twenty percent), for local tax payer and Fixed Business Form;
   2) 20% (twenty percent) or in accordance with tariff on P3B, for bagi for tax payer resident/ domiciled abroad;
from excess of selling price nominal value over price of Bond’s acquisition, not include current interest (accrued interest).

c. For zero coupon bond:
   1) 20% (twenty percent), for local tax payer and Fixed Business Form;
   2) 20% (twenty percent) or in accordance with tariff on P3B, for bagi for tax payer resident/ domiciled abroad;
from excess of selling price nominal value over price of Bond’s acquisition.

Under Keputusan Direktur Jenderal Pajak (KDJP) Nomor KEP - 241/PJ./2002 tanggal 16 Mei 2002 juncto KDJP Nomor KEP-241/PJ./2002 tanggal 30 April 2002 tentang tata cara dan prosedur pelaksanaan pemotongan pajak penghasilan atas bunga dan diskonto obligasi yang diperdagangkan dan atau dilaporkan perdagangannya di Bursa Efek, the cuts of income tax pemotongan Pajak Penghasilannya also carried out by issuer or custodian atau kustodian designated as the payment agent for:

1) Interest received or obtained by bond holder with coupon at the time of interest’s maturity date; and
2) Discount received or obtained by bond holder with coupon and no interest bond at the time of bond’s maturity date;

Referred income tax cutter have to report the cut and the deposit of income tax to Tax Office no later than date 20 on the next month following the cut month by using Surat Pemberitahuan Masa Pajak Penghasilan or Surat Pemberitahuan Masa Pajak Penghasilan.

FIFO principle: Taxation – CGT (Capital Gain Tax): FIFO (First in first out) principle for trades, however, client can trade-allocate if so desired; in absence of client instruction, FIFO will be applied; trade-by-trade.

2. Collect taxes procedure

Tax office has mission to collect taxes for government, KSEI already has feature to calculate CGT (Capital Gain Tax) for transactions, and thus BI may not need to provide such functionality.

CGT evident – traders tend to use favourable DTA (Avoidance of double taxation agreements) domiciles (In many case Singapore – Custodian’s Singapore office); custodian withholds but client calculates and instructs including tax amount.

Selling bonds attracts CGT; seller’s agent to calculate, buyers agent to withhold and pay to tax authorities. As a result, seller will need to amend original instructions after calculation of tax impact.

Documentation required to prove applicable tax rate is complex, 2 docs: COR (Certificate of Residence) / COD (Certificate of Domicile) and certificate from issuer; CIR/COD to be renewed annually, issuer cert valid only for one month; withholding of tax strictly on basis of supporting docs received.

Some issuers are very strict; some issuers are actively working with KSEI on solutions.
KSEI is withholding agent for government bond transactions.
Indonesia has recently enacted regulations concerning the application of its DTAs to a non-Indonesian resident recipient (“Recipient”) of income paid by an Indonesian payer.

These regulations are effective from 1 January 2010 and they provide that if a Recipient intends to claim withholding tax benefits under a relevant DTA, it must submit a timely application for a certificate of domicile (“CoD”).

This CoD uses a standard form issued by the Indonesian tax authority which can either be found in Forms DGT 1 or DGT 2, depending on the circumstances of the Recipient.

The CoD form must be filled in and signed by the Recipient and is to be certified by the foreign competent authority of the jurisdiction where the Recipient is a tax resident in.

The Indonesian payer then will submit the CoD form together with its monthly tax return to the tax office before the end of the monthly tax reporting period (i.e. 20th of the following month).

Form DGT 1 that applies to non-banks is valid for up to 12 months if (i) the Recipient receives the income from the same Indonesian payer; and (ii) the name and address of the Recipient remain the same during the 12-month period. As for Form DGT 2 that applies for banks, it is also valid for 12-month period and can be copied or reused by different Indonesian payers but the copy must be validated by the head of local tax office where the first Indonesian payer is registered.

The Recipient should note that the CoD form is to be submitted before each payment is made by an Indonesian payer to him, failing which no treaty benefit will be available to him.

If the Recipient is only able to provide the CoD form after the monthly tax reporting period is over and the withholding tax has been applied at the general rate in accordance with the applicable Indonesian Income Tax Law (i.e. 20%), the Recipient is still able to apply for a tax refund.

The refund mechanism likely follows the existing tax refund mechanism, in which the application will be submitted to the local tax office where the Indonesian payer is registered.

Since Singapore is one of Indonesia’s DTA partners, the new regulations would affect a Singapore tax-resident Recipient in the following way.

When an Indonesian payer makes payment to the Singapore tax-resident Recipient and Indonesian withholding tax is due on the payment, the Singapore tax-resident Recipient cannot claim Singapore-Indonesia treaty benefits on the payment unless IRAS certifies the CoD form that has been filled in and signed 2 Tax Client Alert _February 2010 by the Singapore tax-resident Recipient and the CoD form is submitted to the Indonesian tax authority before the payment is made.

IRAS has since issued an informal clarification on this CoD certification procedure.
When the Singapore tax-resident Recipient applies to IRAS for certification of the CoD, IRAS is only expected to provide certification on the residence status of the Singapore tax-resident Recipient. In other words, IRAS will provide certification of the CoD if the Singapore tax-resident Recipient satisfies the requirements of Article 4(1) of the Singapore-Indonesia DTA (i.e. for non-individual persons, management and control has to be in Singapore).

The certification process by IRAS is expected to take between two weeks to a month from the date of receipt of the duly completed CoD. Please let us know if further advice is needed on this certification procedure.

http://www.bakermckenzie.com/RRIndonesiaRegulationsAvoidanceDoubleTaxationMay10/

O. Other Regulatory reporting requirements

1. Reporting requirements in case of direct deal between issuers and investors
   
   Included in the reporting obligation regulation number X.M.3, although it is not specifically stated. The reporting obligation is for any kind of bond transaction.

2. Outbound investment
   
   Relevant law governs investment guidelines for e.g. insurance and pension funds, focus on risk management – application of law regardless of domestic or international investments.

3. Reporting requirements in the Foreign Currency denominated instruments
   
   As stated on Peraturan Bapepam and LK Nomor IX.A.11 tentang Penawaran Umum Efek Bersifat Utang Dalam Denominasi Mata Uang Selain Mata Uang Rupiah, Underwriter or issuer (in case of no Underwriter) have to submit report concerning the amount and the maturity date of payment of EBU’s principle and interest denominated in currencies other than Rupiah to Bapepam and LK and send the copy to BI no later than 5 (five) working days following the date of allotment.

4. Non-IDR bonds issuances
   
   Non-IDR bonds issuances are permitted, no such issues have been done; instead, Indonesian government prefers Rule 144A or Samurai bond issues; however, requests from the market for non-IDR issues in the domestic market have been noticed – this due to the substantial USD liquidity in the market, held e.g. by banks and insurance, as well as exporters.

P. Challenges / Expected changes - Policy Initiatives and Reforms

1. Indonesia Capital Market Plan
   
   The Capital Market and Financial Institution Supervisory Board (BAPEPAM-LK) operates on a 5-year capital market plan. The most recent plan (2010-2014) outlines specific development strategies for various market participants and a general strategy for the capital market and non-bank financial industry. Proposed reforms are also included in the Capital Market Plan.
Market Masterplan had laid out three pillars; all achieved in recent years:
   a. Bond pricing (agency).
   b. Reporting of bond trades.
   c. Consolidation of wholesale and retail markets.

Related Resources:
The Capital Market and Non Bank Financial Industry Master Plan 2010-2014

2. Indonesian Banking Architecture

The Indonesian Banking Architecture (weblink provided below) establishes the banking system’s direction, outline, and working structures for a 5-10 year period in support of a strong, stable, and efficient banking system that promotes national economic growth.

The Indonesian Banking Architecture comprises the following sections:
   a. Six Pillars of Indonesian Banking Architecture;
   b. Challenges Ahead;
   c. Action Plan; and
   d. Phases of Implementation

Related Resources:
Indonesian Banking Architecture
http://www.bi.go.id/web/en/Perbankan/Arsitektur+Perbankan+Indonesia/

3. Blueprint for the Development of Islamic Banking

Bank Indonesia (BI) maintains a 10-year blueprint for the development of Islamic banking. The blueprint formalizes Indonesia’s strategic bid to strengthen Islamic banking institutions with respect to shari’a compliance, regulatory structures, operational efficiency, and systemic stability. This effort is regarded as an important step towards building Indonesia’s Islamic capital markets.

Related Resources:
Blueprint of Islamic Banking Development in Indonesia
http://www.bi.go.id/web/en/Publikasi/Perbankan+dan+Stabilitas+Keuangan/Laporan+Perbankan+Syariah/blueprint.htm
III. Trading of Bonds and Trading Market Infrastructure

A. Trading Platforms

Various platforms are needed to ensure that the bond market is performing effectively. These platforms are under the supervision of the following regulatory agencies: the Indonesia Stock Exchange (distribution and trading), PT Penilai Harga Efek Indonesia (pricing), and Bank Indonesia and Indonesian Central Securities Depository (clearing and settlement).

B. Trading of Bonds on Stock Exchange

Traded EBU is EBU scripless listed on Stock Exchange and could be traded on regular and negotiations market based on Peraturan Perdagangan Efek Bersifat Utang Nomor II.F: Tentang Ketentuan Umum Perdagangan Efek Bersifat Utang Di Bursa.

Trading of EBU on Stock Exchange under Peraturan Perdagangan Nomor II.F.1 tentang Tata Cara Perdagangan Efek Bersifat Utang.

On regular market, trading of EBU conducted among Exchange Member through continuous auction based on price and time priority on Fixed Income Trading System (FITS).

Before matching, Exchange Member could amend or withdraw the offer which already been sent through FITS. Trading of EBU on negotiations market occurs based on deals between:

1. two Exchange Member; or
2. One Exchange Member to fulfill the needs of different clients and/or to fulfill the needs of its self.

C. OTC Trading of Bonds

In OTC transaction, there are broader traders and the transactions made by negotiation mechanism. The settlement of Government Securities is done via sub registry designated by BI on BI-SSSS. While the settlement for OTC transaction on Corporate Bond done by KSEI (C-BEST).

D. Bond Repurchase Market

Bapepam-LK has not specifically regulate Bond Repurchase Market yet, however it already accommodated accounting treatment for issuer and or Securities Company as the participant of SUN trading operator over the counter, who are conducting Repo an Reverse Repo transactions using MRA under Peraturan Bapepam dan LK Nomor VIII.G.13: Perlakuan Akuntansi Repurchase Agreement (repo) dengan Menggunakan Master Repurchase Agreement (MRA).
Issuer and or Securities Company which conducting Repo an Reverse Repo transactions have to record securities rate which being transacted over the period of tenure. Referred Securities Company have to report Bapepam and LK under form and Peraturan Bapepam dan LK Nomor V.D.5: Pemeliharaan dan Pelaporan Modal Kerja Bersih Yang Disesuaikan.

Bapepam-LK, BI, and DJPU take policy as stated on Indonesia Capital Market Development Program Cluster – Subprogram 2 ADB to GMRA Indonesian Annexes. In this project, Bapepam-LK, BI, and DJPU act as a facilitator. Standardization agreement in form of GMRA Indonesian Annexes is expected to encourage development of Repo transaction to all market participants.

Whereas, preparation of GMRA Indonesian Annexes conducted by Himdasun or Primary Dealer, SRO's Asosiasi Perusahaan Efek Indonesia, and other related association as market participants.

Activities that have completed are team formation, Business Workshop on GMRA, review of GMRA and Annexes from other countries and initial business for legal drafting need. Current activity is legal drafting process of GMRA Indonesian annex by designated law firm.

E. Fixed Income Trading Systems (FITS)

1. Corporate Bond:

FITS (Fixed Income Trading System) is EBU trading facilities using computer facilities through Stock Exchange (IDX).

Peraturan Perdagangan Efek Bersifat Utang Nomor II.F: Tentang Ketentuan Umum Perdagangan Efek Bersifat Utang Di Bursa stated that EBU transactions could only been done among Exchange Member via FITS Firm Manager and or FITS Trader designated by referred Exchange Member and implemented via FITS.

FITS process the offer buy and sell by Exchange Member based trading limit.

For corporate bonds traded on Stock Exchange, it’s clearing and guarantee made by KPEI. Meanwhile, it’s settlement conducted by KSEI.

2. Government Bond:

Based on PMK Nomor 170/PMK.08/2008 tentang Transaksi SUN Secara Langsung, SUN Transaction Directly is sale of SUN on primary market or buyback of SUN on secondary market, which conducted by Government and Primary Dealer, BI or LPS directly via Dealing Room facility on DJPU.

Refered transaction held by Finance Minister, which conducted by DJPU, in order to implement SUN market stabilization, management of SUN portfolio or achievement needs of SBN net on current year State Budget.

This provision in accordance with PMK Nomor 92/PMK.08/2010 tentang Perubahan atas PMK Nomor 170/PMK.08/2008 tentang Transaksi SUN secara Langsung, which regulates that Government could conduct SUN Transaction Directly to Primary Dealer, BI, or LPS.

In order to obtain the reference price in SUN Transaction Directly, DJPU c.q. unit Eselon II which perform the transaction could use price quotation SUN benchmark
series sent by Primary Dealer through trading infrastructure system of Primary Dealer; and or request the Primary Dealer, BI and/or LPS to submit bidding price. Meanwhile, trading system used by Primary Dealer is developed by each of Primary Dealer. For Government bonds traded on Stock Exchange, it’s clearing and guarantee made by KPEI. Meanwhile, it’s settlement conducted by KSEI.

3. Secondary Market Interests and Terms of Bond Issues

Government securities are already used as benchmark price for financial instruments such as corporate bonds. Mostly bonds with big outstanding including benchmark government bonds more liquid compared with others.

4. Transparency in Bond Pricing

Based on Peraturan Bapepam dan LK Nomor X.M.3: Pelaporan Transaksi Efek, each transaction of EBU, and Sukuk which has been sold through IPO, SBN and other securities set to reported by Bapepam dan LK, which is traded on secondary market, shall be reported to Bapepam-LK through PLTE. The reporting conducted via Centralized Trading Platform PLTE, and participant which conduct the report shall submit transaction data including the price of
securities transaction. In addition, based on Bapepam Rule No. V.C.3 concerning Lembaga Penilai Harga Efek, there is expectation the obtained of fair value reference for the investor.

Investors may access government securities prices through several sources: (i) Bloomberg quotation; (ii) Inter Dealer Market Association Page; (iii) Indonesia Stock Exchange; (iv) money brokers’ quotation; (v) Primary Dealers quotation; and (iv) Bond Pricing Agency.

F. Bond and Sukuk Trading Mechanism

1. Fixed Income Trading System (FITS) Trading Mechanism

Fixed Income Trading System (FITS) through Stock Exchange is used for Trading of Bond (Corporate & Government) and Sukuk.

FITS system users is Securities Company that already become IDX Exchange Members, and also KPEI Clearing Members.

In transaction activities through FITS, Exchange Members are responsible for all transaction, whether for its client and its company.

a. Fixed Income Trading System (FITS)

Fixed Income Trading System (FITS) is Bonds and Sukuk trading facilities provided by Indonesia Stock Exchange (IDX). Bonds and Sukuk that can be transacted through FITS are Bonds and Sukuk listed on Indonesia Stock Exchange.

Bonds and Sukuk trading mechanism through FITS system is integrated between trading system for clearing and settlement, as in the above chart there are three different mechanisms, such as trading, clearing and settlement.

b. The IDX maintains the SSX system for bond transactions:

i. The Fixed Income Trading System (FITS) is a scripless trading system for listed bonds, including retail bonds. FITS uses the automated securities trading system platform, which allows remote trading between market participants; and

ii. The Centralized Trading Platform, which was inaugurated in September 2006, ensures that all bond transactions are reported a maximum of one hour after the transaction has been made. This allows for increased bond price transparency.

c. The FITS of IDX provides members with access to its two trading boards:

i. The Regular Outright Board is a bond trading mechanism that establishes a continuous auction between buyers and sellers based on market price and time; and

ii. The Negotiated Board is a trading facility that allows IDX members to disclose the results of negotiated trade transactions with another party.
The Indonesia Bond Pricing Agency (IBPA) was established in July 2008 to improve transparency and ensure a fair trading environment in the bond market. With the creation of a bond pricing agency, all market participants are given equal access to price information to aid investment decisions. The IBPA is responsible for establishing daily reference prices for government and corporate bonds, including conventional and Islamic debt issues.

In addition to free price-related information, the IBPA provides bond market research for a fee to institutional and retail investors.

Related Resources:
Indonesia Bond Pricing Agency (In Bahasa Indonesia)
http://www.ibpa.co.id/
IV. Possible item of Impediments / Restrictions

A. Taxation (WH Tax on Interest Income, Stamp Duty, Tax Report Requirement, etc.)

*PP Nomor 16 Tahun 2009 tentang Pajak Penghasilan Atas Penghasilan Berupa Bunga Obligasi* regulates concerning taxation provisions of capital gain and Bond interest.

The amount of income tax has differences between resident and non-resident as follows:

1. Bond interest with coupon rate of 15% for local tax payer and Fixed Business Form, and 20% or based on rate on tax treaty for foreign tax payer apart from Fixed Business Form, from the gross amount of interest based on period of bond ownership.

2. Discount from bond with coupon rate of 15% for local tax payer and Fixed Business Form, and 20% or based on rate on tax treaty for foreign tax payer apart from Fixed Business Form, from the difference of selling price or nominal value over the acquisition price of Bond, excluding accrued interest.

3. Discount from no coupon bond is 15% for local tax payer and Fixed Business Form, and 20% or based on rate on tax treaty for foreign tax payer apart from Fixed Business Form, from the difference of selling price or nominal value over the acquisition price of Bond.

In addition, there is tax treaty with more than 50 countries including Singapore.

B. Disclosure & Investor Protection Rules for Issuers

1. Several documents concerning disclosure should exercised by supporting professional registered in Bapepam-LK

2. Legal jurisdiction for bonds issued by non-residents should be Indonesian Law

3. There are Obligation to acquire investment rating at the issuance of the bond (Bapepam rule No. IX.C.11).

C. Underwriting Rules for Financial institutions

There is only rule for Underwriting licence for Securities Company.

D. Restrictions on OTC Transactions by Residents

Investment policy guideline of resident investors such as insurance and pension funds is developed by the authority in order to manage the risk. The elimination of investment restriction on resident investor greatly depends upon the authority’s policy.

E. Credit Rating System and its relation to Regulations

There are Obligation to acquire investment rating at the issuance of the bond (IX.C.1 dan IX.C.11).

Licensing procedure and requirements for CRA are set in Bapepam Rules No.IX.C.2. other rules concerning CRA in Indonesia are:
F. Utilization of Shelf-Registration System / MTN

In order to facilitate the issuance of MTN which allows a firm to issue a series of bonds within a particular period with only once registration statement submission, Bapepam-LK just released a new regulation on shelf registration.

G. Availability of Information in English

Most of Bapepam regulations are available in English

H. Restrictions in Accounting Standard

Financial report prepared based on accounting principals that generally accepted which is Standar Akuntansi Keuangan set by Ikatan Akuntan Indonesia (IAI), and accounting provisions in capital market as stated on Bapepam and LK Rules No.X.K.2 and VIII.G.7.

I. Limited Opportunities to Utilize Bond Holdings / Repo Market

Insurance company and dan Pension Funds prohibited from engaging in REPO transaction based on KMK No. 424/KMK.06/2003.

J. Currency Controls

Central bank regulations prohibit movements of IDR (Rupiah) (1) between two non-resident accounts and (2) from residents to non-residents, unless the movements are related to economic activities in Indonesia, such as direct investments or transfers of ownership of direct investments and payments related to transactions involving IDR-denominated securities.

Offshore transfers of IDR are prohibited.

If the total accumulated funds credited to a non-resident account on a single given day exceeds IDR500 million, the investor must provide authenticated supporting documentation, such as a copy of the purchase or sale agreement for direct investments, a copy of the securities purchase or sale confirmation from a broker or other authorized party for securities portfolio transactions, or a copy of the dividend payment confirmation from the issuing company.

For accumulated amounts under IDR500 million, supporting documentation is not required, but a declaration on the underlying economic transactions should be provided.

BI requires that all investors who purchase foreign currencies against IDR in an amount greater than the equivalent of USD100,000 per calendar month provide documents stating that all foreign exchanges (FXs) are supported by underlying activities and a letter declaring the validity of all supporting documents provided.

The declaration letter, which must include the customer name, the bank name, the
nominal purchase of foreign currency against IDR, and a statement confirming the validity of the transaction, must be submitted to BI according to the schedule below:

For all the clients’ purchases booked through the custodian’s on-book account with the cash correspondent, custodian will submit one blanket statement according to the above schedule to cover these purchases.

Investors who do not abide by the above regulations are subject to a penalty of IDR10 million accompanied by a written warning letter for each offense.

All non-resident foreign exchange transactions must be done onshore; offshore foreign exchange transactions are prohibited.

Onshore foreign exchange activities with non-residents are limited to USD1 million per bank on outstanding positions unless there is underlying economic activity, as outlined above.

A non-resident’s IDR current account cannot, under any circumstances, be overdrawn overnight.

BI maintains a restriction on forward exchange trading. Forward transactions are allowed, provided that the value date of the forward transaction is the same as the settlement date of the underlying economic transaction and the transactions are supported by authenticated documents.

Hedging transactions are allowed only for the purpose of investment in Indonesia for a minimum tenor of three months and must be accompanied by documents supporting the hedging and investment.

Third-party foreign exchanges are allowed; however, supporting documentation for the underlying transactions must be provided to the third-party foreign exchange bank.

<table>
<thead>
<tr>
<th>Foreign currency purchase amount</th>
<th>Frequency of statement letter</th>
</tr>
</thead>
<tbody>
<tr>
<td>Non-custody clients</td>
<td>Custody clients</td>
</tr>
<tr>
<td>Local</td>
<td>Local</td>
</tr>
<tr>
<td>Less than or equal to USD100,000 per month</td>
<td>Monthly</td>
</tr>
<tr>
<td>Greater than USD100,000 per month</td>
<td>Per FX transaction on booking date + supporting document</td>
</tr>
</tbody>
</table>

* The exception to this rule is derivative transactions for hedging purposes. The term of the hedging contract must not be less than three months and not more than the term of the investment. It must be accompanied by documents supporting the underlying investment being hedged

** Please note that the USD 1 million limits are applicable to total outstanding transactions with all offshore customers of the bank. These include FX derivative transactions against IDR like Outright forward sale/purchase, Swaps and options, and other similar derivative transactions.

K. Funding Procedures

All cash trades are settled only if clear funds are available in client’s account. Local
regulations do not permit an overdraft in non-resident investor accounts.
V. High level description of the securities settlement system

A. Securities settlement infrastructure

1. BI:

Bank Indonesia (BI) acts as a central registry in conducting the registration, clearing, settlement, payment, and redemption of government securities.

BI appoints a bank or financial institution as the sub-registry to operate as custodian for each individual customer accounts.

To administer transactions for government securities and Sertifikat Bank Indonesia (SBI), BI employs the Bank Indonesia - Scripless Securities Settlement System (BI-SSSS).

This system is an information portal that facilitates electronic auctions and the settlement of government securities for market participants.

The system is linked seamlessly to BI’s Real-Time Gross Settlement System. As a result, transactions are conducted on a delivery-versus-payment (DVP) basis.

OTC Market Business Process Flow (Direct Connection to BI-SSSS)
(The following numbers are linked to above chart explanations)

1. The seller and the buyer trade the government bond over-the-counter (OTC).
2. Both seller and buyer send matching instruction.
3. Pre-matching is performed via telephone or swift.
4. Participants have to input reporting code that got from CTP, in BI-SSSS within
30 minutes of trade.
5. Both seller and buyer key in the DVP instruction to BI-SSSS.
6. BI-SSSS performs the matching.
7. BI-SSSS reports the matching results to the seller and the buyer.
8. Payment message for DVP is sent to BI-RTGS (Bank Indonesia Real Time Gross Settlement)
9. When the funds are available, the amount is debited from the buyer’s cash account and credited to the seller’s cash account.
   Moreover, BI-RTGS sends the cash settlement statements to the seller and the buyer.
10. BI-RTGS notifies the Irrevocable Debit/ Credit status to BI-SSSS.
11. BI-SSSS performs bond settlement.
12. BI-SSSS reports the settlement status to both seller and buyer.

BI settlement has no pre-matching concept, hence via phone.
BI matching based on both parties instruction input or upload of instructions.
Custodian like DB downloads data (completion advice) from BI, cannot connect host-to-host.
BI cash transactions are received by DB’s Treasury side.
ISO 20022 are generally seen as changes relative to corporate actions messages, with significant gains over ISO 15022 in this area.
Client communication in ISO15022, plus emails as necessary (e.g. funding report, enquiries).
Instructions for securities settlement and cash funding or payment would typically be given simultaneously; this due to need to link FX with underlying transaction and need to prove funding before settlement is effected; alternatively MT210.
Intraday facilities are generally permitted, availability may depend on intermediary.
STP concept is based on BI-SSSS format, not international standards.
BI is developing a next generation system; new system may also support segregated account structure.
KSEI is planning to have direct account relationship at/with BI.
Default: regulations not entirely clear, distributed among separate laws; market practice filling gaps.

Two BI departments involved in bond market: Payments and Settlements.

On trade reporting: buyer and seller report trade individually; custodian/settlement agent to report trades as well, citing CTP number.

Bapepam-LK wants BI to ensure that trades are reported; no reporting, no settlement.

KSEI already is member of BI-RTGS, for its function as sub-registry.

(Almost) all government bonds are listed, but not traded on exchange.

Key point: KSEI’s use of payment banks is due to specific features offered by payment banks to participants, in particular intraday facilities. But Capital Market Masterplan, authored by Bapepam-LK, describes conversion for all market cash settlements to BI-RTGS eventually.

BI sends separate confirmations for BI-SSSS and BI-RTGS following settlement; all messaging in proprietary format.
However, the Next Gen System project considers a CCP function and international messaging standards; location/entity of the CCP has not been decided upon.
Industry by-laws (set by ‘Participant Association’) stipulate settlement by 3pm; most settlements happen in the pm.

BI has introduced time-sensitive pricing for settlement charges (in 2004 – ABS Automated Billing System), in order to defray a settlement peak volume in the afternoons; with limited success.

Taxation: Next Gen System project has allowance to facilitate transport of tax information.

Overseas issues: SUN (Promissory Notes), global bonds; 30% in US, 30% in Eurozone, rest elsewhere; settlement and depository by BoNY Mellon, not available through BI-SSSS.

Indonesia has ability to issue non-IDR bonds domestically; Next Gen System will feature multi-currency capabilities.

Linkages: presently, a connection to HK USD clearing has been established, but is not yet operational; BI focusing on central bank to central bank connectivity, where issue is harmonisation of processes and approaches (e.g. haircuts).

For ASEAN or cross-border issues/projects, BI generally tends to follow Bapepam’s guidance/lead.

2. KSEI:

The main functions of the Indonesian Central Securities Depository (KSEI) are the registration of listed corporate bonds and management of depository accounts. KSEI also facilitates the settlement of securities from the Indonesian exchanges.

KSEI designed the Central Depository and Book-Entry Settlement System to carry out the electronic registration and settlement of securities, including shari’a bonds, multi-currency bonds, and promissory notes.

Bond settlement infrastructure diagram (Indonesia)
Pre-matching is done via phone, for those who do not use C-BEST. KSEI cannot provide unmatched reasons, hence C-BEST pre-matching not often used.
Also for following reasons: need CTP code (obtained when reporting trade for price discovery), 6-digits; client typically does not provide code in instruction; and CGT.

KSEI can maintain individual account holder level, but omnibus account at BI.
KSEI uses 4 payment banks: BCA, CIMB Niaga, Mandiri, Permata. Presently, an RfP (Request for Proposal) is being prepared to review existing payment banks, possibly add more. Banks are chosen on their strength, technology capabilities and member benefits.

IDX is the bond pricing agency, appointed by Bapepam for this purpose. And has set up a separate legal entity: Indonesia Bond Pricing Agency (IBPA).

All trades on IDX are routed to KPEI, the clearing house for CCP. Bond trades on exchange are handled in e-BOCS, including allocations.

Affirmations in e-BOCS only required for brokers.

Settlement for IDX trades happens in KSEI (C-BECT). Transaction status in C-BEST is available for viewing, download every 15 minutes.

KSEI can settle transactions for bonds denominated in IDR or USD. While Sukuk are not traded on IDX, settlement is done at KSEI.

Selling bonds attracts CGT; seller’s agent to calculate, buyers agent to withhold and pay to tax authorities.

As a result, seller will need to amend original instructions after calculation of tax
impact. Documentation required to prove applicable tax rate is complex, 2 docs: COR/COD and certificate from issuer; CIR/COD to be renewed annually, issuer cert valid only for one month; withholding of tax strictly on basis of supporting docs received. Some issuers are very strict; some issuers are actively working with KSEI on solutions. KSEI is withholding agent for government bond transactions.

Cash is settled via payment banks if settlements are made between KSEI account holders. Otherwise cash settlement is using BI’s RTGS system. BI-RTGS cut-off time is 2 pm; payment bank cut-off time is 3 pm (although individual banks may have shorter cut-off times for specific clients).

No 3rd party access to KSEI is allowed; only brokers and custodians as participants.

3. Outside of the BI and KSEI systems:

For securities transacted outside of the BI and KSEI systems, a transfer agent licensed by the Capital Market and Financial Institution Supervisory Board (BAPEPAM-LK) is contracted to maintain registry and custody records.

4. Custodian

a. Custodian uses only one payment bank for settlement via KSEI.
b. Affirmation at KPEI level, seller initiates, using CTP number.
c. Broker can delegate e-BOCS affirmations to settlement agent.
d. No 3rd Party Clearing (TPC) evident in market, although regulations silent on subject.
e. According to general clearing membership rules, custodians cannot be clearing members.
f. Custodian needs to download trade data (trade-by-trade)

B. Definition of Clearing and settlement

The definition of clearing in Bapepam-LK regulation NO.III.A.10 re: securities transactions as follows:

"Clearing is a process of determining the rights and obligations that arise from Exchange transactions"

While the definition of settlement as referred to KSEI regulation re: central depository services (chapter 8) "Securities transaction settlement services are part of Central Depository services provided for the fulfilment of rights and obligations as the results of Stock Exchange Transactions or Over-the-Counter Transactions conducted by means of book-entry of Securities and / or funds between Securities accounts."

C. Challenges/ Expected changes

Development plans: Masterplan laid out big picture desired for technology landscape going forward, and for some market developments, e.g.:

1. BI Next Gen System project
2. KSEI as direct participant in BI-SSSS (done)
3. KSEI as direct participant in BI-RTGS; however, for KSEI to participate, it will have to obtain a (restricted) banking license
4. Bapepam would like to merge depository functions, but law stipulates BI as depository for government securities; one possibility to have BI outsource depository operation to KSEI, while retaining fiscal/fiduciary functions;

There is no direct co-ordination on technology developments between Bapepam-LK and BI.

BI and KSEI already are SWIFT enabled, but securities firms typically do not use; limitation of funding options for securities firms means limited budget for (tech) investments.

KSEI will introduce ‘AKSES’ as product allowing investors to check all their holdings at KSEI level, across intermediaries, using the new Single Investor ID; as long as all custodian/brokers for same client use SID.

3rd Party Clearing (TPC) not available, but discussed among regulators and SROs.
**VI. Cost and charging methods**

Maintenance (on-going) Costs and Initial Fees

A. MARKET COSTS

1. Stamp Duty

Stamp duty is applicable to registration fees. The following Stamp duty is applicable on securities traded in Indonesia.

<table>
<thead>
<tr>
<th>Transaction Value</th>
<th>Stamp Duty (IDR)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Less than IDR1,000,000</td>
<td>3,000</td>
</tr>
<tr>
<td>More than IDR1,000,000</td>
<td>6,000</td>
</tr>
</tbody>
</table>

2. Brokerage

For a purchase/sale of securities, an investor is charged with a commission fee by the brokers. The amount of fee is determined by the exchange. On the Indonesia Stock Exchange (IDX), the brokerage commission fee is set at maximum 1 % of the transaction value. For right issue transactions, IDX does not prescribe any ceiling on brokerage fee. In such cases, the brokerage is mutually agreed between the investor and the broker.

3. Registration Costs

There are no registration costs applicable to dematerialized securities traded across the exchange. However, registration costs are applied if investors dematerialize securities held in physical form or re-certificate securities held in dematerialized form.

To dematerialize physical shares, the shares must be registered in the client’s name. If the shares are not registered in the client’s name, the client should provide a power of attorney (PoA) issued in the current registered name for the conversion process.

There is a registration fee of between IDR2000 and IDR10,000 plus 10% value added tax per certificate for physical share denominations up to 50,000. For physical certificate share denominations greater than 50,000, the registration fee is calculated using the formula 1/1000 x total nominal value, with a minimum of IDR25,000 and a maximum of IDR10 million (total nominal value = the number of shares X nominal or par value of the shares).

There is also a conversion fee of between IDR1500 and IDR10,00 per certificate with a minimum fee of IDR20,000 plus 10% value added tax. For physical certificate share denominations greater than 50,000 the conversion fee is calculated using the formula 1/1000 x total nominal value, with a minimum of IDR25,000 and a maximum of IDR10 million (total nominal value = the number of shares x nominal or par value of the shares).

Stamp duty is applicable on the total amount of registration fees on a registration application form. This stamp duty is generally payable by the investor and calculated based on the receipt for the registration fees. Investors may withdraw their dematerialized holdings from KSEI and convert them into physical form.
Such shares will be registered according to the name specified in the PoA. KSEI will charge a fee calculated as follows: 0.1% \times \text{quantity} \times \text{closing market price} (\text{subject to tax}), with a minimum of IDR25,000 and a maximum of IDR500,000. The registrar will issue the scrip in a jumbo lot and charges a fee calculated as follows: 0.1\% \times \text{quantity} \times \text{nominal value} (\text{subject to tax}), with a minimum of IDR27,500 and a maximum of IDR550,000. The fee for splitting shares is IDR3000 (plus 10\% \text{value added tax}).

4. Other Costs

KSEI levies a dormant account fee of IDR1 million per month for any account that has no holdings and has not executed a trade for six months. If an investor closes a dormant account mid-month, the fee will be pro-rated. KSEI will give at least 30 days notice to allow investors an opportunity to close their accounts or to purchase securities before the charge is applied.
Total local currency (LCY) bonds outstanding in Indonesia expanded 2.8% y-o-y as of end-December 2010 to reach IDR956.1 trillion (USD106.3 billion). On a quarter-on-quarter (q-o-q) basis, however, bonds outstanding fell 4.4% in 4Q 2010.

As of end-December 2010, the growth in total government bonds outstanding was flat on a y-o-y basis.

The 10.2% y-o-y growth in the stock of central government bonds (treasury bills and bonds issued by the Ministry of Finance) in 4Q 2010 was offset by the 23.0% y-o-y decline in the stock of central bank bills issued by BI in the form of Sertifikat Bank Indonesia (SBI).

Meanwhile, corporate bonds outstanding grew 29.8% y-o-y to IDR114.8 trillion (USD12.8 billion) in 4Q 2010.

Source of data: http://www.bapepam.go.id/pasar_modal/publikasi_pm/statistik_pm/index.htm

### Value of Bond Issuance (Rp M)

<table>
<thead>
<tr>
<th>Period</th>
<th>IPO of Bond</th>
<th>2nd Issuance and so on</th>
<th>Saria Bond</th>
<th>Convertible Bond</th>
<th>Sek. Kredit</th>
<th>Total</th>
<th>US$ Bonds</th>
</tr>
</thead>
<tbody>
<tr>
<td>As of 23 December 2010</td>
<td>59.523</td>
<td>152.576</td>
<td>Not mention</td>
<td>1.825</td>
<td>0.003</td>
<td>213.927</td>
<td>$ 105mil.</td>
</tr>
<tr>
<td>As of 30 December 2009</td>
<td>50.823</td>
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<tr>
<td>As of 30 December 2008</td>
<td>46,343</td>
<td>93,047</td>
<td>4,697</td>
<td>1.825</td>
<td>0.003</td>
<td>145,915</td>
<td></td>
</tr>
</tbody>
</table>

### Bonds Trading Data through PLTO BEI (Rp M)

<table>
<thead>
<tr>
<th>Period</th>
<th>Listed Bonds (Outstanding) (Rp M)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>SUN Bonds</td>
</tr>
<tr>
<td>As of November 2010</td>
<td>649,173.10</td>
</tr>
<tr>
<td>2009</td>
<td>574,658.87</td>
</tr>
<tr>
<td>2008</td>
<td>525,694.73</td>
</tr>
</tbody>
</table>

### Composition of Bond Holding as of 30 November 2010 (Rp M)

<table>
<thead>
<tr>
<th>Holding</th>
<th>Government Bond</th>
<th>%</th>
<th>Corporate Bond</th>
<th>%</th>
</tr>
</thead>
<tbody>
<tr>
<td>Foreign</td>
<td>298.55</td>
<td>2.22</td>
<td>3,424.97</td>
<td>3.28</td>
</tr>
<tr>
<td>Local</td>
<td>13,149.10</td>
<td>97.78</td>
<td>101,746.23</td>
<td>96.74</td>
</tr>
</tbody>
</table>

### Value of Bond Issuance (Rp M)

<table>
<thead>
<tr>
<th>Period</th>
<th>IPO of Bond</th>
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<td>145,915</td>
</tr>
</tbody>
</table>
Value of IPO of Bond (Rp M)

<table>
<thead>
<tr>
<th>Period</th>
<th>IPO of Bond</th>
</tr>
</thead>
<tbody>
<tr>
<td>As of 23 December 2010</td>
<td>59,523</td>
</tr>
<tr>
<td>As of 30 December 2009</td>
<td>50,823</td>
</tr>
<tr>
<td>As of 30 December 2008</td>
<td>46,343</td>
</tr>
</tbody>
</table>

Total of issuers which already have an effective notice to offer bonds for public (not include US$ Bond)

<table>
<thead>
<tr>
<th>Type of issuers</th>
<th>Total Issuers</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>up to the 23th of December 2010</td>
</tr>
<tr>
<td>Financial</td>
<td>73</td>
</tr>
<tr>
<td>non-financial</td>
<td>116</td>
</tr>
</tbody>
</table>

Total of financial and non-financial issuers which have IPO of Bond, 2nd Issuance and so on, Subordinated Bond, Saria Bond, US$ Bond (not include US$ Bond)

Type of investors for bonds as of 30 November 2010 (Rp M)

<table>
<thead>
<tr>
<th>Type of investors</th>
<th>Government Bond</th>
<th>Corporate Bond</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Value of foreign investors</td>
<td>Value of local investors</td>
</tr>
<tr>
<td>Corporate</td>
<td>15.00</td>
<td>603.75</td>
</tr>
<tr>
<td>Individual</td>
<td>6.90</td>
<td>10,628.74</td>
</tr>
<tr>
<td>Mutual Fund</td>
<td>2.80</td>
<td>942.81</td>
</tr>
<tr>
<td>Securities Company</td>
<td>0.00</td>
<td>38.92</td>
</tr>
<tr>
<td>Insurance</td>
<td>0.00</td>
<td>216.00</td>
</tr>
<tr>
<td>Pension Fund</td>
<td>24.38</td>
<td>351.13</td>
</tr>
<tr>
<td>Financial Institution</td>
<td>65.47</td>
<td>236.47</td>
</tr>
<tr>
<td>Fondation</td>
<td>0.00</td>
<td>72.36</td>
</tr>
<tr>
<td>Others</td>
<td>184.00</td>
<td>58.93</td>
</tr>
</tbody>
</table>

Size of LCY Bond Market in USD

http://asianbondsonline.adb.org/indonesia/data/bondmarket.php?code=LCY_in_USD_Local

<table>
<thead>
<tr>
<th>Date</th>
<th>Govt (in USD Billions)</th>
<th>Corp (in USD Billions)</th>
<th>Total (in USD Billions)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Dec-97</td>
<td>0</td>
<td>2.81</td>
<td>2.81</td>
</tr>
<tr>
<td>Dec-98</td>
<td>0</td>
<td>1.73</td>
<td>1.73</td>
</tr>
<tr>
<td>Dec-99</td>
<td>46.86</td>
<td>2.00</td>
<td>48.85</td>
</tr>
<tr>
<td>Dec-00</td>
<td>50.84</td>
<td>1.95</td>
<td>52.79</td>
</tr>
<tr>
<td>Dec-01</td>
<td>47.22</td>
<td>1.81</td>
<td>49.03</td>
</tr>
<tr>
<td>Dec-02</td>
<td>53.30</td>
<td>2.40</td>
<td>55.70</td>
</tr>
<tr>
<td>Dec-03</td>
<td>59.09</td>
<td>5.39</td>
<td>64.48</td>
</tr>
<tr>
<td>Dec-04</td>
<td>54.28</td>
<td>6.34</td>
<td>60.62</td>
</tr>
<tr>
<td>Date</td>
<td>Govt (in %GDP)</td>
<td>Corp (in %GDP)</td>
<td>Total (in %GDP)</td>
</tr>
<tr>
<td>---------</td>
<td>----------------</td>
<td>----------------</td>
<td>----------------</td>
</tr>
<tr>
<td>Dec-97</td>
<td>0</td>
<td>2.4</td>
<td>2.4</td>
</tr>
<tr>
<td>Dec-98</td>
<td>0</td>
<td>1.4</td>
<td>1.4</td>
</tr>
<tr>
<td>Dec-99</td>
<td>30.3</td>
<td>1.3</td>
<td>31.5</td>
</tr>
<tr>
<td>Dec-00</td>
<td>35.4</td>
<td>1.4</td>
<td>36.8</td>
</tr>
<tr>
<td>Dec-01</td>
<td>29.8</td>
<td>1.1</td>
<td>31.0</td>
</tr>
<tr>
<td>Dec-02</td>
<td>26.2</td>
<td>1.2</td>
<td>27.4</td>
</tr>
<tr>
<td>Dec-03</td>
<td>24.7</td>
<td>2.3</td>
<td>27.0</td>
</tr>
<tr>
<td>Dec-04</td>
<td>21.9</td>
<td>2.6</td>
<td>24.5</td>
</tr>
<tr>
<td>Mar-05</td>
<td>19.5</td>
<td>2.4</td>
<td>21.9</td>
</tr>
<tr>
<td>Jun-05</td>
<td>20.3</td>
<td>2.5</td>
<td>22.7</td>
</tr>
<tr>
<td>Sep-05</td>
<td>17.1</td>
<td>2.3</td>
<td>19.4</td>
</tr>
<tr>
<td>Dec-05</td>
<td>17.1</td>
<td>2.1</td>
<td>19.2</td>
</tr>
<tr>
<td>Mar-06</td>
<td>18.2</td>
<td>2.0</td>
<td>20.2</td>
</tr>
<tr>
<td>Jun-06</td>
<td>18.7</td>
<td>2.0</td>
<td>20.7</td>
</tr>
<tr>
<td>Sep-06</td>
<td>18.8</td>
<td>1.9</td>
<td>20.7</td>
</tr>
</tbody>
</table>

Size of LCY Bond Market in % GDP

http://asianbondsonline.adb.org/indonesia/data/bondmarket.php?code=LCY_in_GDP_Local
<table>
<thead>
<tr>
<th>Year</th>
<th>Govt Bonds (in USD billions)</th>
<th>Corp Bonds (in USD billions)</th>
<th>Total (in USD billions)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Mar-05</td>
<td>8.46</td>
<td>0.34</td>
<td>8.80</td>
</tr>
<tr>
<td>Jun-05</td>
<td>7.90</td>
<td>0.32</td>
<td>8.22</td>
</tr>
<tr>
<td>Sep-05</td>
<td>7.07</td>
<td>0.35</td>
<td>7.42</td>
</tr>
<tr>
<td>Dec-05</td>
<td>3.10</td>
<td>0.21</td>
<td>3.31</td>
</tr>
<tr>
<td>Mar-06</td>
<td>8.83</td>
<td>0.21</td>
<td>9.04</td>
</tr>
<tr>
<td>Jun-06</td>
<td>8.62</td>
<td>0.13</td>
<td>8.75</td>
</tr>
<tr>
<td>Sep-06</td>
<td>10.89</td>
<td>0.46</td>
<td>11.35</td>
</tr>
<tr>
<td>Dec-06</td>
<td>10.84</td>
<td>1.04</td>
<td>11.88</td>
</tr>
<tr>
<td>Mar-07</td>
<td>13.85</td>
<td>0.79</td>
<td>14.64</td>
</tr>
<tr>
<td>Jun-07</td>
<td>22.37</td>
<td>1.08</td>
<td>23.45</td>
</tr>
<tr>
<td>Sep-07</td>
<td>18.88</td>
<td>1.15</td>
<td>20.03</td>
</tr>
<tr>
<td>Dec-07</td>
<td>14.86</td>
<td>0.75</td>
<td>15.61</td>
</tr>
<tr>
<td>Mar-08</td>
<td>13.41</td>
<td>0.77</td>
<td>14.18</td>
</tr>
<tr>
<td>Jun-08</td>
<td>13.88</td>
<td>0.84</td>
<td>14.72</td>
</tr>
<tr>
<td>Sep-08</td>
<td>14.41</td>
<td>0.73</td>
<td>15.14</td>
</tr>
<tr>
<td>Dec-08</td>
<td>8.06</td>
<td>0.43</td>
<td>8.49</td>
</tr>
<tr>
<td>Mar-09</td>
<td>6.66</td>
<td>0.33</td>
<td>6.99</td>
</tr>
<tr>
<td>Jun-09</td>
<td>10.24</td>
<td>0.50</td>
<td>10.74</td>
</tr>
<tr>
<td>Sep-09</td>
<td>9.30</td>
<td>0.38</td>
<td>9.68</td>
</tr>
<tr>
<td>Dec-09</td>
<td>13.59</td>
<td>0.72</td>
<td>14.31</td>
</tr>
<tr>
<td>Month</td>
<td>Value 1</td>
<td>Value 2</td>
<td>Value 3</td>
</tr>
<tr>
<td>--------</td>
<td>---------</td>
<td>---------</td>
<td>---------</td>
</tr>
<tr>
<td>Mar-10</td>
<td>18.08</td>
<td>1.16</td>
<td>19.24</td>
</tr>
<tr>
<td>Jun-10</td>
<td>22.99</td>
<td>1.23</td>
<td>24.22</td>
</tr>
<tr>
<td>Sep-10</td>
<td>19.48</td>
<td>1.40</td>
<td>20.88</td>
</tr>
<tr>
<td>Dec-10</td>
<td>19.11</td>
<td>1.21</td>
<td>20.32</td>
</tr>
<tr>
<td>Mar-11</td>
<td>24.17</td>
<td>1.41</td>
<td>25.58</td>
</tr>
</tbody>
</table>
VI. Presence of an Islamic Finance (Islamic bond (Sukuk)) market

According to Bapepam-LK Rule No IX.A.13 concerning Issuance of Sharia Securities, Sukuk is Sharia Securities in a form of certificate or proof of ownership which have the same value and represent participation unit which is not separated from or consists of.

Islamic bonds (Sukuk) in Indonesia have had the following fatwa and legal basis:

1. Fatwa No. 32/DSN-MUI/IX/2002 concerning Sharia Bonds
2. Fatwa No. 33/DSN-MUI/IX/2002 concerning Shariah Mudharabah Bonds
5. Fatwa No. 59/DSN-MUI/V/2007 concerning conversion of Sharia Mudharabah Bonds
6. Fatwa No. 69/DSN-MUI/VI/2008 concerning the Government Sharia Securities (SBSN)
7. Fatwa No. 70/DSN-MUI/VI/2008 concerning the method of SBSH Issuance
8. Fatwa No. 71/DSN-MUI/VI/2008 concerning of Sale and Lease Back of Ijarah SBSN
9. Fatwa No. 69/DSN-MUI/VI/2008 concerning SBSN Ijarah Sale and Lease Back

GOVERNMENT SUKUK:

DOMESTIC ISSUANCE:

1. Book Building (Finance Minister Regulation No. 118/PMK.08/2008 regarding Domestic Sukuk Issuance In Primary Market Through Bookbuilding);
2. Auction (Finance Minister Regulation No. 11/PMK.08/2009 regarding Government Sukuk Auction In Primary Market);
3. Book Building (Finance Minister Regulation No. 218/PMK.08/2008 regarding Retail Sukuk In Primary Market); Changes: No. 10/Pmk.08/2007; 172/Pmk.08/2010;
4. Private Placement (Finance Minister Regulation No. 75/PMK.08/2009 regarding Government Sukuk Private Placement Issuance)

INTERNATIONAL ISSUANCE:

1. Book Building/Public Offering Finance Minister Regulation No. 152 /PMK.08/2008 regarding Foreign Denominated Sukuk Issuance In International Market; The Changes: No. 129/PMK.08/2009;

   ⊲ Recognition of Sukuk established/issued under foreign law
IX. History of Debt Market development
X. Next Step → Future Direction

Refer to Indonesia Capital Market and Financial Institution Master Plan at:

A. Future Direction

In January 2011, the Ministry of Finance and the State Enterprises Ministry signed a memorandum of understanding requiring state-owned firms to act as stand-by purchasers of government bonds in the event of sudden capital outflows.

Under the scheme, a bond stabilization fund will be created to help protect the economy in case of sudden capital flight.

The government has appointed 13 major state companies and financial institutions to participate in the bond stabilization fund.

These 13 companies comprise four banks (Bank Mandiri, Bank Rakyat Indonesia, Bank Negara Indonesia, and Bank Tabungan Negara), and nine non-banks and insurance companies (including Jaminan Kredit Indonesia and Asuransi Kredit Indonesia).

Market development: FSA concept (i.e. convergence of supervisory powers into single agency) planned, but slow moving; several major (desirable) developments, including e.g. a possible convergence of depositories into a single entity, should not be expected before conclusion of implementation.

B. G-30 Compliance\(^2\)

<table>
<thead>
<tr>
<th>Recommendation</th>
<th>Implemented</th>
</tr>
</thead>
<tbody>
<tr>
<td>1 Eliminate paper and automate communication, data capture, and enrichment.</td>
<td>Yes</td>
</tr>
<tr>
<td>2 Harmonize messaging standards and communication protocols.</td>
<td>No</td>
</tr>
<tr>
<td>3 Develop and implement reference data standards.</td>
<td>Yes</td>
</tr>
<tr>
<td>4 Synchronize timing between different clearing and settlement systems and associated payment and foreign exchange systems.</td>
<td>Yes</td>
</tr>
<tr>
<td>5 Automate and standardize institutional trade matching.</td>
<td>No</td>
</tr>
<tr>
<td>6 Expand the use of central counterparties.</td>
<td>Yes</td>
</tr>
<tr>
<td>7 Permit securities lending and borrowing to expedite settlement.</td>
<td>Yes</td>
</tr>
<tr>
<td>8 Automate and standardize asset servicing processes, including corporate actions, tax relief arrangements, and restrictions on foreign ownership.</td>
<td>No</td>
</tr>
<tr>
<td>9 Ensure the financial integrity of providers of clearing and settlement services.</td>
<td>Yes</td>
</tr>
<tr>
<td>10 Reinforce the risk management practices of users of clearing and settlement service providers.</td>
<td>No</td>
</tr>
<tr>
<td>11 Ensure final, simultaneous transfer and availability of assets.</td>
<td>Yes</td>
</tr>
</tbody>
</table>

\(^2\) The G30 recommendations are taken from the Group of Thirty’s report Global Clearing and Settlement – A plan of action (Copyright © 2003 Group of Thirty) http://www.partad.ru/wrld/word/g30app1.pdf
<table>
<thead>
<tr>
<th></th>
<th>Ensure effective business continuity and disaster recovery planning.</th>
<th>No</th>
</tr>
</thead>
<tbody>
<tr>
<td>13</td>
<td>Address the possibility of failure of a systematically important institution.</td>
<td>No</td>
</tr>
<tr>
<td>14</td>
<td>Strengthen assessment of the enforceability of contracts.</td>
<td>Yes</td>
</tr>
<tr>
<td>15</td>
<td>Advance legal certainty over rights to securities, cash, or collateral.</td>
<td>Yes</td>
</tr>
<tr>
<td>16</td>
<td>Recognize and support improved valuation methodologies and closeout netting arrangements.</td>
<td>Yes</td>
</tr>
<tr>
<td>17</td>
<td>Ensure appointment of appropriately experienced and senior board members (of the boards of securities clearing and settlement infrastructure providers).</td>
<td>Yes</td>
</tr>
<tr>
<td>18</td>
<td>Promote fair access to securities clearing and settlement networks.</td>
<td>Yes</td>
</tr>
<tr>
<td>19</td>
<td>Ensure equitable and effective attention to stakeholder interests.</td>
<td>Yes</td>
</tr>
<tr>
<td>20</td>
<td>Encourage consistent regulation and oversight of securities clearing and settlement service providers.</td>
<td>Yes</td>
</tr>
</tbody>
</table>


<table>
<thead>
<tr>
<th>Potential barrier area</th>
<th>Current situation</th>
<th>Market Assessment Questionnaire scores</th>
<th>Overall barrier assessment</th>
</tr>
</thead>
<tbody>
<tr>
<td>Quotas</td>
<td>There are no quotas on foreign involvement in the local market. There are no significant limits on foreign investor holdings in individual issues.</td>
<td>OK</td>
<td>OK</td>
</tr>
<tr>
<td>Investor registration</td>
<td>There is no requirement for foreign investor registration.</td>
<td>OK</td>
<td>OK</td>
</tr>
<tr>
<td>FX controls - conversion</td>
<td>Foreign exchange activities of each bank are restricted to 20% of total capital per day, shared between the bank's customers. Offshore foreign exchange transactions are prohibited. Third-party FX trades are allowed. However, given the restrictions and risks associated with the movement of funds in the market, custodians may not support third party FX. Investors who purchase foreign currencies against IDR more than the equivalent of USD 100,000 per calendar month must make a declaration stating that all FX activity is supported by underlying investments and a letter declaring the validity of all supporting documents provided. Non-resident custody clients can provide an annual blanket confirmation. Reports on IDR transfers are submitted on a monthly basis by custodian banks. Reports on FX transactions effected are submitted on a daily basis. Comments from market participants indicated some investor perception of these currency controls being problematic. 8 survey responses mentioned Indonesia as a problem in this area.</td>
<td>HIGH</td>
<td>HIGH</td>
</tr>
<tr>
<td>FX controls - repatriation of funds</td>
<td>Similar controls are imposed on repatriation of funds. 6 survey responses mentioned Indonesia as a problem in this area.</td>
<td>LOW</td>
<td>LOW</td>
</tr>
<tr>
<td>Potential barrier area</td>
<td>Current situation</td>
<td>Market Assessment Questionnaire scores</td>
<td>Overall barrier assessment</td>
</tr>
<tr>
<td>---------------------------</td>
<td>-------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------</td>
<td>----------------------------------------</td>
<td>---------------------------</td>
</tr>
<tr>
<td>Cash controls - credit balances</td>
<td>IDR received from an FX which is to be used for the purchase of securities can only be held in the non-resident account for a maximum of 2 working days. Failed trades are not common in the Indonesian market, but should a purchase trade not have settled by SD+1, the custodian will be forced to reverse the initial FX and sell the IDR same-day. The IDR cannot remain in the account, although it can be used to fund another purchase. There are significant restrictions on credit balances, but some flexibility.</td>
<td>LOW</td>
<td>LOW</td>
</tr>
<tr>
<td>Cash controls - overdrafts</td>
<td>A non-resident’s IDR current account cannot, under any circumstances, be overdrawn overnight. Intra-day overdrafts are allowed. However, in practice, sales proceeds cannot be used to fund purchases of the same value date due to limited cut-off time of securities settlement. Therefore, while pre-funding in the sense that funds are needed prior to settlement date is not required, foreign investors must ensure that sufficient IDR funds are in their account on SD, without allowing for any sales proceeds due in that day, to ensure purchases are settled.</td>
<td>LOW</td>
<td>HIGH</td>
</tr>
<tr>
<td>Taxes</td>
<td>Withholding taxes are applied both when selling bonds and at the maturity of bonds. Market participants need to track historic trades in order to calculate the tax on a sale. For foreign investors, the standard rate of withholding tax is 20%. Double-taxation treaties can reduce this to 10%. Exemption is currently obtained by submitting an original Certificate of Domicile/Residency. Additional documentation may be required under the new Indonesian income tax law (as from 1 January 2009), but the implementation guidelines have not yet been issued. It appears there are ambiguities in the tax regulations in Indonesia and tax reclaim is a cumbersome and lengthy process. Investors commented that tax is complex and high and terminology can be unclear. 6 survey responses mentioned Indonesia as a problem in this area. It was also mentioned that there have been some improvements in recent years.</td>
<td>HIGH</td>
<td>HIGH</td>
</tr>
<tr>
<td>Omnibus accounts</td>
<td>Omnibus accounts are permitted. However, for tax reasons it may be advisable to open individual accounts, and many investors now do so.</td>
<td>OK</td>
<td>OK</td>
</tr>
<tr>
<td>Settlement cycle</td>
<td>The settlement cycle for bonds is negotiated, normally on T+2, but can be settled between T+1 to T+7.</td>
<td>OK</td>
<td>OK</td>
</tr>
<tr>
<td>Message formats</td>
<td>The CSD, and most local market participants, do not currently use ISO 15022 / 20022 message formats.</td>
<td>LOW</td>
<td>LOW</td>
</tr>
<tr>
<td>Securities numbering</td>
<td>ISIN codes are available for all local bond issues, and are available at the time of issue. However, the CSD, and most local market participants, do not currently use ISIN</td>
<td>LOW</td>
<td>LOW</td>
</tr>
<tr>
<td>Potential barrier area</td>
<td>Current situation</td>
<td>Market Assessment Questionnaire scores</td>
<td>Overall barrier assessment</td>
</tr>
<tr>
<td>------------------------</td>
<td>-----------------------------------------------------------------------------------</td>
<td>----------------------------------------</td>
<td>---------------------------</td>
</tr>
<tr>
<td>codes in securities messages.</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Matching</td>
<td>There are trade matching and pre-settlement matching systems for bonds.</td>
<td>OK</td>
<td>OK</td>
</tr>
<tr>
<td>Dematerialisation</td>
<td>The market is basically dematerialised but some physical bond certificates still exist (if issued prior to 2000).</td>
<td>LOW</td>
<td>LOW</td>
</tr>
<tr>
<td>Regulatory framework</td>
<td>Perceived regulatory risk, especially fear of capital controls, is a factor in investors' minds. It was commented that immediate regulatory changes are often made, and rules can be ambiguous.</td>
<td>-</td>
<td>HIGH</td>
</tr>
</tbody>
</table>
Definitions

The following list presents some of the definitions commonly used in discussion on clearing and settlement topics.

Extract from P.286 BIS Papers No 30 « Clearing, settlement and depository issues »
http://www.bis.org/publ/bppdf/bispap30z.pdf

**Clearing.** Generally, clearing refers to the process of comparing trades before settlement date or the determination of the net obligations of the broker participants (for both securities and cash). In certain publications, clearing may be used synonymously with settlement.

**Settlement.** The settlement process refers to the exchange of cash and securities on the contractual settlement date. The settlement date can be agreed upon at trade execution or can be prescribed by local trading conventions. Settlement may be processed on a provisional or a final basis.

**Settlement finality.** The exchange of cash and securities is final when a settlement can no longer be unwound. Finality eliminates the main legal risks of payment and settlement systems, reduces systemic risk and ensures the smooth operation of a system.

**Gross settlement.** Gross settlement systems settle transactions on an instruction by instruction and real-time (RTGS) basis throughout the day. RTGS systems are costly due to the need for collateral or available cash balances to cover payment obligations during the day or for securities lending programmes to cover short securities positions. RTGS systems, however, typically reduce systemic risk.

**Net settlement.** In net settlement systems, obligations are settled at the end of the business day on a net basis. The net process is subject to potential systemic risk, due to the contagion effect where incoming funds are relied upon to make onward payments when a participant cannot meet his obligations. As there is no requirement to post collateral or keep cash balances readily available during the day, net systems tend to be less costly.

**Central securities depository (CSD).** A CSD is either the physical entity or the system that facilitates the settlement and safekeeping of securities and ensures the reconciliation of participant accounts. Securities can be safekept in immobilised or dematerialised form. Settlement generally occurs in book entry form.

**International central securities depository (ICSD).** An ICSD is a depository settling trades in international and various domestic securities, usually through direct and indirect links with agents in the domestic markets. The best known ICSDs are Euroclear Bank and Clearstream International. The eurobond market developed in part in response to operational and regulatory inefficiencies in domestic bond markets.

**Central counterparty (CCP).** A CCP acts as counterparty to every buy and sell trade, a process known as “novation”. This process concentrates counterparty risk and provides multilateral netting.
Contributors to the making of this market guide

- Yunita Linda Sari  yunita@bapepam.go.id
- Market Profile provided by Citi
- Deutsche Bank Domestic Custody Services, Market Guide Vietnam, July 2009
- 2010 – THE GUIDE TO CUSTODY IN WORLD MARKETS by State Street
- asianbondsonline.adb.org

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E-Mail:  shige.inukai@river.dti.ne.jp
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   B. Methods of Issuing Bonds
   C. Credit-Rating Agencies and Credit Rating of Bonds
   D. Bond Related Systems for Investor Protections
   E. Governing laws of bond issuance
   F. Transfers of interests in bonds
   G. Definition of securities
   H. Self-governing rules behind the market
   I. Bankruptcy procedures
   J. Meetings of bondholders
   K. Event of default
   L. Options available on the bond market
   M. Parties involved in a bond issue and their respective roles
   N. Major Players in the Market

II. Primary and secondary market regulatory frameworks
   A. Malaysia Market Regulatory Structure
   B. Regulation of the Malaysian securities markets
   C. Issuing debt instruments related regulations / rules
   D. Buying debt instruments related regulations / rules (Investment in debt securities)
   E. Investor Protection
   F. Taxation Framework and Tax requirements
   G. Offers of bonds to professionals
   H. Definition of “sophisticated investors” in Malaysia
   I. Challenges / Expected changes

III. Trading of Bonds and Trading Market Infrastructure
   A. OTC market trading
   B. Exchange trading

IV. Possible item of Impediments / Restrictions
   A. Repo market
   B. Liquidity in the secondary market
   C. Conclusion

V. High level description of the securities settlement system
   A. Securities settlement infrastructure
   B. Definition of Clearing and settlement
   C. Challenges/ Expected changes

VI. Cost and charging methods
   A. Maintenance (on-going) Costs
   B. Initial Fees

VII. Market size / statistics
   A. Equity market
   B. Sukuk market
   C. Market size

VIII. Presence of an Islamic Finance (Islamic bond (Sukuk)) market
   A. Regulatory framework for Islamic Finance in general
   B. Type of instruments available, segments, tenure, e.g.
   C. Basic Market infrastructure required to facilitate Islamic Finance
   D. Tax related issues

IX. History of Debt Market development

X. Next Step — Future Direction
   A. Local currency bond market
   B. Enhancements to post-trade processing in Asian bond markets
C.  G-30 Compliance
D.  GOE Barrier Report Market assessment - Malaysia
I. High Level Structure, Type & Characteristics of the Market

A. Types of Bonds

1. By issuer category

   a. Bonds issued by public entities

      i. Government securities

      ii. Bank Negara Monetary Notes (BNMN)

         BNMN are issued for the purpose of managing liquidity in both conventional and
         Islamic financial markets and can be on discount-based, or coupon-based. The
         maximum maturity of BNMN is three years. These replaced the Bank Negara
         Bills and Bank Negara Negotiable Notes.

      iii. Government-related corporations

   b. Bonds issued by private entities

      i. Financial institutions

      ii. Local corporates

      iii. Multilateral development banks (MDB)

      iv. Non-MDB offshore borrowers

2. By type of bonds

   a. Straight Bonds (Government Bonds / Corporate Bonds)

   b. Floating Rate Notes

   c. Zero-coupon Bonds

   d. Islamic Debt Securities

      Islamic debt securities, also called sukuk, are structured to comply with Shariah
      principles, which prohibit the charging of interest. The Malaysian sukuk has
      taken the lead in developing and innovating new Islamic securities structures
      and in pioneering the Islamic capital market.

   e. Medium-term Notes

   f. Convertible Bonds

   g. Bonds with Warrants

   h. Asset-backed Securities

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1 e.g. Khazanah Nasional Berhad and Cagamas Berhad.
3. Money Markets instruments
   
a. Commercial Paper
b. Repo

4. By listing status
   
a. Debt Securities Listed and Traded on Bursa Malaysia

   Debt securities listed and traded on the exchange, called loan stocks, have 3 types: (i) redeemable convertible loan stocks – debt securities that give the holders the right to convert the loan stocks into new ordinary shares during a specified period, at a pre-determined conversion rate and price; (ii) irredeemable convertible loan stocks – debt securities that confer the holders the right to convert the stocks into new ordinary shares; and (iii) redeemable non-convertible loan stocks – debt securities that cannot be converted into ordinary shares.

b. Listed Debt Securities and Sukuk under Exempt Regime

   This framework is applicable to debt securities and sukuk that are issued, offered or subscribed in accordance with section 229(1) and section 230(1) of CMSA.

c. Bonds non-listed, can be traded over-the-counter (OTC)

B. Methods of Issuing Bonds

1. Government bonds (conventional and sukuk)

   Government bonds are issued via competitive auction by Bank Negara Malaysia on behalf of the government. Successful bidders are determined according to the lowest yields offered and the coupon rate is fixed at the weighted average yield of successful bids.

2. Bank Negara Malaysia Notes

   Bank Negara Notes are offered through competitive auction by principal dealers.

3. Bonds issued by other statutory bodies and government-owned corporations

   Methods are similar to those of issuing corporate bonds stated below.

4. Methods of issuing Corporate Bonds

   Corporate bonds may be issued by direct placement or tender.

C. Credit-Rating Agencies and Credit Rating of Bonds

   There are two credit rating agencies in Malaysia that provide independent opinions on the credit risks and potential default risks of specific issuers. The first rating agency, Rating Agency Malaysia Berhad (now known as RAM Ratings Services Berhad), was established in November 1990; and the second, Malaysian Rating Corporation, was
incorporated in October 1995. Currently, all issues, offers or invitations of private debt securities must be rated by a rating agency recognised by the Securities Commission, unless exemptions were given the Securities Commission.

Refer to these links for details:
Rating Agency Malaysia Berhad (www.ram.com.my)
Malaysian Rating Corporation (www.marc.com.my)

D. Bond Related Systems for Investor Protections

The Commission may require a person to disclose to the Commission, in relation to any dealing in securities or trading in futures contracts whether or not the dealing or trading was carried out on another person’s behalf-

a. the name of, and particulars sufficient to identify the person from whom, through whom or on whose behalf the securities or futures contracts were dealt with, as the case may be;
b. the nature of the instructions given to that person in relation to the dealing in securities or trading in futures contracts;

c. the particulars of the dealing in securities, including-
   (i) particulars of the securities that were dealt with; and
   (ii) particulars of consideration given or received for the dealing in securities or any other transaction related to the dealing in securities;
d. the particulars of trading in futures contracts,
e. any other information in the possession of the person as the Commission may specify as it thinks expedient for the due administration of this Act.

E. Governing laws of bond issuance

Dealing in securities is a regulated activity under the Capital Markets and Services Act 2007. Specific laws governing different types of bonds are summarised as follows:

1. Government bonds

Bank Negara Malaysia's (BNM) manages the liabilities of the government, both in Malaysia and abroad. It advises the government on its loan programs, including planning the government securities auction calendar, taking into considerations the terms and timing of the loans and issue of new types of securities. It participates in the monthly Cash Flow Committee meeting chaired by the Treasury to discuss the final details of Government securities issuances. BNM is responsible for trading, registering, settlement and redemption of Government securities through the automated trading and settlement system developed by the Central Bank.

BNM published the rules on Real Time Electronic Transfer (RENTAS) System and Fully Automated System for Issuing/Tendering (FAST).

2. Corporate Bonds/Asset-Backed Securities

The Securities Commission (SC) oversees the issuance of private debt securities (PDS), asset-backed securities (ABS), Islamic securities, and structured products. SC provides guidelines on the offering of these securities and approves private debt securities' prospectuses, which are lodged with the Companies Commission of Malaysia.
Corporations may issue private debt securities without prior assessment by SC, but only if the private debt securities guidelines on transparency have been met. This is in line with SC’s disclosure-based regulatory framework for fund raising.

For foreign issuers, the Quick Reference for Information on Cross-Border Bond Issuance and Investment, contains information on bond issuance by nonresidents in Malaysia.

Under BNM’s Foreign Exchange Administration Policies, proceeds of bond issuances are not to be used for refinancing of offshore borrowing and/or financing of investments abroad exceeding MYR10 million in aggregate in a calendar year. The National Bond Market Committee Negative List, which identifies activities where proceeds from PDS and ABS issuances cannot be used, was repealed on 28 March 2005.

F. Transfers of interests in bonds

Malaysian Government debt securities are scripless, so securities transfer is electronic. In the Real-time Electronic Transfer of Funds and Securities (RENTAS) system under Bank Negara Malaysia, transfer instructions are done on a trade-by-trade basis, with the transfer of securities simultaneous with the transfer of funds for payment.

More information can be read through the following links:


G. Definition of securities

Securities are defined as:
(a) debentures, stocks or bonds issued or proposed to be issued by any government;
(b) shares in or debentures of, a body corporate or an unincorporated body; or
(c) unit trusts or prescribed investments, and includes any right, option or interest in respect thereof, but does not include futures contracts.2

Definition of debentures

"Debenture" includes debenture stock, bonds, notes and any other evidence of indebtedness of a corporation for borrowed monies, whether or not constituting a charge on the assets of the corporation, but shall not be construed as applying to any of the following:

(a) any instrument acknowledging or creating indebtedness for, or for money borrowed to defray the consideration payable under, a contract for sale or supply of goods, property or services or any contract of hire in the ordinary course of business;

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2 Section 2(1) of the Capital Markets and Services Act 2007 ("CMSA")
(b) a cheque, banker’s draft or any other bill of exchange or a letter of credit;

(c) a banknote, guarantee or an insurance policy;

(d) a statement, passbook or other document showing any balance in a current, deposit or savings account;

(e) any agreement for a loan where the lender and borrower are signatories to the agreement and where the lending of money is in the ordinary course of business of the lender, and any promissory note issued under the terms of such an agreement; or

(f) any instrument or product or class of instruments or products as the Minister may, on the recommendation of the Commission, prescribed by order published in the Gazette.

H. Self-governing rules behind the market

I. Bankruptcy procedures

Malaysia’s laws on bankruptcy have been established in the Companies Act 1965, Bankruptcy Act 1967, and in their respective rules and in various amendments.

The Companies Act 1965 contains provisions for insolvency, rehabilitation, appointment of receivers, and winding-up procedures for companies. Specific laws governing industries may also have provisions governing insolvency of a company (e.g., the Banking and Financial Institutions Act 1989 for banks). The Bankruptcy Act 1967 covers bankruptcy laws for individuals. Insolvency Asia reports on the insolvency law regime in Malaysia are linked below.

J. Meetings of bondholders

The trustee is responsible for a resolution of a meeting of bondholders. Meetings may be convened at the request of the issuer, trustee or an agreed percentage of debenture holders. There should be a quorum requirement for the transaction of business at the meetings. The quorum for the passing of special resolutions should be explicitly stated in the trust deed.

K. Event of default

The events of default are usually negotiated terms but the Trust Deed Guidelines issued by the Securities Commission provides for the minimum contents requirements for such trust deed. The trust deed and the terms and conditions of debentures must provide for, but should not be limited to, the following:\n
(i) a list of all events, the occurrence of any of which would entitle or oblige the trustee to declare the debentures immediately due and repayable (to the extent

3 Guidelines on the Minimum Contents Requirements for Trust Deeds issued by the Securities Commission
appropriate and subject to any materiality thresholds and provision for remedy or period of grace which may be negotiated) including the following:

(a) where there is any default in payment of any principal, premium or interest or profit rate (where applicable) under the debentures;

(b) where a winding up order has been made against the borrower or a resolution to wind up the borrower has been passed;

(c) where a scheme of arrangement under section 176 of the Companies Act 1965 has been instituted against the borrower;

(d) where a receiver has been appointed over the whole or a substantial part of the assets of the borrower;

(e) where there is a breach by the borrower of any term or condition in the debentures or provision of the trust deed or of any other document relating to the issue, offer or invitation in respect of the debentures;

(f) where any other indebtedness of the borrower becomes due and payable prior to its stated maturity or where the security created for any other indebtedness becomes enforceable;

(g) where there is a revocation, withholding or modification of a licence, authorisation or approval that impairs or prejudices the borrower’s ability to comply with the terms and conditions of the debentures or the provisions of the trust deed or any other document relating to the issue, offer or invitation in respect of the debentures.

(ii) the powers of the trustee upon the occurrence of any event described in subparagraph (i) including:

(a) the powers of the trustee to declare the debentures immediately due and repayable;

(b) the powers of the trustee to enforce the provisions of the trust deed;

(c) the circumstances under which the trustee shall be bound to enforce the provisions of the trust deed; and

the circumstances under which the holders of the debentures are entitled to pursue their rights and remedies

L. Options available on the bond market

1. Currency

The most common currencies in which bonds are denominated are: MYR, USD and
USD-denominated debt securities and sukus will be settled in RENTAS on DvP basis while those denominated in other foreign currencies may be settled on a non-DvP basis.

2. Convertible bonds

Convertible bonds are fixed rate securities that grant the bondholders the right to convert the bonds into a specific number of the issuer's common shares at a pre-determined conversion rate and price. When a convertible bond is exercised, the investor loses the income from the future redemption value of the bond. Convertibles appeal to investors who seek both the cashflow and safety of a bond while still enjoying the prospects of capital appreciation should the company's ordinary shares perform well.

3. Bonds with Warrants

Bonds with warrants allow listed companies to raise capital, initially in the form of debt and subsequently in the form of equity, at a premium to its current share price and at a lower interest cost than would be achievable through a straight bond issue. When the warrants are exercised, new money is used to subscribe for the shares, increasing the borrower's capitalisation.

M. Parties involved in a bond issue and their respective roles

1. Lead Arranger/Principal Advisor

2. Advisor

For the purpose of issuance of foreign currency-denominated bonds and sukuk under the Joint Information Note on the Issuance of Foreign Currency-Denominated Bonds and Sukuk in Malaysia issued by Bank Negara Malaysia and the Securities Commission, an advisor means:
   a. Commercial banks licensed under the Banking and Financial Institutions Act 1989 (BAFIA);
   b. Islamic banks licensed under Islamic Banking Act 1983;
   c. Investment banks licensed as both a merchant bank pursuant to Section 5 of the BAFIA and as a dealer to the CMSA, and duly established pursuant to the Guidelines on Investment Banks jointly issued by Bank Negara Malaysia and the SC.

3. Underwriter

4. Facility Agent

5. Paying Agent

6. Legal Counsel

7. Shariah Advisor

8. Trustee
Trustees for a bond or sukuk issue have the responsibility of safeguarding the interests of the bond holders. The trustee will vet through the Transactions Documents of a bond or sukuk issue to ensure the following:

a. That there are no inconsistencies or conflicts of interest between the provisions of the trust deed and the conditions stated in the SC’s letter of approval and in the term sheet approved by SC;
b. That there are no provisions in any of the Transaction Documents that are inconsistent or in conflict with, or may lead to inconsistency or conflict with, the trustee’s duties; and
c. That the SC’s *Guidelines on the Minimum Content Requirement for Trust Deeds* have been complied with.

9. Credit Rating Agency

The credit rating agency performs the following functions:

a. Investor protection
b. Enlarged investor pool
c. Information disclosure
d. Lower cost of borrowing
e. Aids pricing decisions

10. Financial Guarantee Institution

N. Major Players in the Market

1. Issuer

The central government of Malaysia issues bills and bonds that are facilitated by Bank Negara Malaysia (BNM). Central government bonds are issued to raise funds from the domestic capital market and for development expenditure. BNM also issues its own treasury bills and bonds for liquidity purposes.

Khazanah Berhad and Cagamas Berhad are the major issuers of quasi-government bonds. Financial institutions, non-financial institutions, and corporations issue private debt and asset-backed securities, commercial papers, and medium-term notes under conventional and Islamic principles.

a. Government
The central government, Bank Negara Malaysia (BNM), and quasi-government institutions such as Khazanah and Cagamas are the main issuers of public debt. Bonds are issued under conventional or Islamic principles.

b. Corporate
Financial institutions, non-financial institutions, and corporations issue private debt and asset-backed securities (ABS), commercial papers (CP), and medium-term notes (MTNs) under conventional and Islamic principles.

CPs and MTNs are short- and medium-term promissory notes used to finance short-term capital needs. MTNs have various forms, including conventional fixed rate, convertibles, low coupons with equities attached, and zero coupon Islamic bonds. Corporate bond structures also vary in terms of coupons: such as fixed or floating-rate, step-up, zero coupon, and with warrants attached. CPs, MTNs and asset-backed securities are also issued by Malaysian corporations.
c. Supranational
In November 2004, the Asian Development Bank (ADB) issued a new asset class, *Putra* bonds, which were MYR400 million fixed-rate bonds. It was the first MYR-denominated bond issued by a foreign entity in Malaysia.

In December 2004, the International Finance Corporation (IFC) issued *Wawasan* bonds, which were MYR500 million 3-year bonds issued under the Islamic principle of *bai bithaman ajil*.

d. Foreign or Offshore Borrowers
For foreign issuers, the Quick Reference for Information on Cross-Border Bond Issuance and Investment, which is linked below, contains information on bond issuance by nonresidents in Malaysia.

2. Investor

Malaysian Government Securities (MGS) dominate the bond market and are primarily issued to the Employee Provident Fund (EPF) to meet its investment needs and to finance government expenditures. Eighty-five percent of MGS holders comprise the EPF, insurance companies, and commercial banks. Government Investment Issues are bought mostly by banks dedicated to Islamic funds. The key investors for Malaysian Treasury Bills are banks, finance companies, and insurance institutions.

Bank Negara Malaysia (BNM) is the largest shareholder of *Cagamas* bonds, which are also held by commercial banks, finance companies, and merchant banks. The corporate bond market has been a captive market for financial institutions.

a. Pension Fund
The Malaysian pension system comprises a series of provident funds, regulated by Bank Negara Malaysia (BNM). The Employees Provident Fund (EPF) is a significant investor in the bond market. It is the largest provident fund and accounts for over 85% of the total assets of the Malaysian provident fund system. EPF is required to invest 30% of its assets in MGS. The Social Security Organization (SOCSO), which provides benefits to workers through the Employment Injury Insurance Scheme and the Invalidity Pension Scheme, invests at least 40% of its funds in government bonds or in bonds issued by government-linked organizations. The Pension Trust Fund, which was transformed into the Retirement Fund under the Retirement Fund Act of 2007, also invests considerable amounts in Malaysian government bonds and other types of fixed income securities.

b. Insurance Companies
Private insurance companies dominate Malaysia’s nonbank financial sector. Since the 1997–98 Asian financial crisis, a merger program had reduced the number of insurers to 41 by the end of 2007.

The *takaful* sector is also experiencing rapid growth. *Takaful*, or mutual support, is the basis of the concept of insurance (solidarity) among Muslims where participants mutually agree to guarantee each other against defined loss or damage that may occur on any of them by donation from *takaful* funds. The number of *takaful* operators increased to eight by the end of 2007 from only three in 2003. The total *takaful* fund assets reached MYR8.8 million by the end of 2008 from MYR4.4 million in 2003.
c. Asset Management
The Securities Commission (SC) began liberalizing Malaysia's unit trust industry in 1997. Since then, the investment management industry has expanded. SC reported that total assets under management by licensed fund management companies in Malaysia increased by 44.13% to MYR236.98 billion by the end of 2007. Unit trust funds continued as the main source of assets under management, reaching MYR169.41 billion by the end of 2007. Other types of assets under management include funds from charitable bodies, corporate bodies, the Employees Provident Fund (EFP) and EPF contributors, government bodies and agencies, individuals, insurance companies, and private pension funds.
II. Primary and secondary market regulatory frameworks

A. Malaysia Market Regulatory Structure

1. Market Entry Requirements

Non-residents are free to invest in Malaysia in any form. There are no restrictions on the repatriation of capital, profits and income earned from Malaysia, including salaries, wages, royalties, commissions, fees, rental, interest, profits or dividends. To complement the non-residents' investment strategy, non-residents may obtain financing from licensed onshore banks both in ringgit and foreign currency and enter into foreign exchange contracts with licensed onshore banks to actively manage currency risks arising from investments in ringgit assets. Kindly refer to [http://bondinfo.bnm.gov.my/portal/server.pt?open=514&objID=27240&parentname=CommunityPage&parentid=822&mode=2&in_hi_userid=202&cached=true](http://bondinfo.bnm.gov.my/portal/server.pt?open=514&objID=27240&parentname=CommunityPage&parentid=822&mode=2&in_hi_userid=202&cached=true) for the details.

1. Bank Negara Malaysia

Established on 26 January 1959 under the Central Bank of Malaysia Act 1958 (CBA 1958). The CBA 1958 has been repealed by the Central Bank of Malaysia Act 2009 which became effective on 25 November 2009. It is a statutory body wholly owned by the Government of Malaysia with the paid-up capital progressively increased, currently at RM100 million. The Bank reports to the Minister of Finance, Malaysia and keeps the Minister informed of matters pertaining to monetary and financial sector policies.

Among the major role of the Bank is the prudent conduct of monetary policy, which has seen generally low and stable inflation for decades and thereby, preserving the purchasing power of the ringgit. The Bank is also responsible for bringing about financial system stability and fostering a sound and progressive financial sector. There is now in place a well diversified, comprehensive and resilient financial sector, that is able to meet the increasingly sophisticated needs of consumers and businesses, and which has become a growth driver in the economy.

The Bank also plays a significant developmental role, including development of financial system infrastructure with major emphasis placed on building the nation's efficient and secured payment systems as well as the necessary institutions (including Securities Commission, KLSE, now known as Bursa Malaysia and Credit Guarantee Corporation) which are important towards building a comprehensive, robust and resilient financial system.

The Bank actively promotes financial inclusion, which has led to improved access to financial services for all economic sectors and segments of society, thereby supporting balanced economic growth.

It is stipulated in the Central Banking Act 1958 (Revised 1994, 2006) that Bank Negara Malaysia can provide temporary advances, known as “ways and means” advances, to the Government to cover any deficit in the budget revenue. However, there are legal limitations to the amount and the duration of loans that Bank Negara Malaysia can make available to the Government. As a result, the Central Bank's holding of MGS is minimal. Since 2005, Bank Negara Malaysia is allowed to purchase MGS from the primary and secondary markets based on
market prices and to use the purchased securities for its open market operations. To ensure that these purchases do not unduly influence or distort market prices, Bank Negara Malaysia's participation in the primary auction is based on the weighted average price of the auction and is limited to a maximum of 10% of the issue size. Similarly, the amount purchased in the secondary market is limited to 10% of the outstanding issued amount. As at end-June 2006, Bank Negara Malaysia holds less than 1% of total MGS outstanding amount.

2. Securities Commission

The Securities Commission (SC) was established on 1 March 1993 under the Securities Commission Act 1993. The SC is a self-funding statutory body with investigative and enforcement powers. It reports to the Minister of Finance and its accounts are tabled in Parliament annually. The SC's many regulatory functions include:

a. Supervising exchanges, clearing houses and central depositories;
b. Registering authority for prospectuses of corporation other than unlisted recreational clubs;
c. Approving authority for corporate bond issues;
d. Regulating all matters relating to securities and futures contracts;
e. Regulating the take-over and mergers of companies;
f. Regulating all matters relating to unit trust schemes;
g. Licensing and supervising all licensed persons;
h. Encouraging self-regulation; and
i. Ensuring proper conduct of market institutions and licensed persons.

The SC administers the Securities Industry Act 1983 which governs a substantial part of activities in the domestic bond market. The SC also has the ultimate responsibility of investor protection. Apart from discharging its regulatory functions, the SC is also obliged by statute to encourage and promote the development of the securities and futures markets in Malaysia.

3. Shariah Advisory Council

To ensure all Islamic capital market products are in compliance with the Shariah principles, the Shariah Advisory Council (SAC) was established in 1996 by the SC for the onshore market. The SAC comprises prominent Shariah scholars, jurists and market practitioners and their role is to advise the SC on matters relating to the Islamic capital market and to provide Shariah guidance on Islamic capital market transactions and activities.

4. Bursa Malaysia

Bursa Malaysia (formerly the Kuala Lumpur Stock Exchange) is now a holding company following demutualization in 2004. Bursa Malaysia is a self-regulatory organization that governs its members' conduct and member companies in securities dealings. It is also responsible for marketplace surveillance. Bursa Malaysia, on behalf of SC, supervises and enforces disclosure standards for listed companies.

B. Issuing debt instruments related regulations / rules

1. Bank Negara Malaysia's (BNM) manages the liabilities of the government, both in

2. The Securities Commission (SC) oversees the issuance of private debt securities (PDS), asset-backed securities (ABS), Islamic securities, and structured products. SC provides guidelines on the offering of these securities and approves private debt securities' prospectuses, which are lodged with the Companies Commission of Malaysia.

3. Corporations may issue private debt securities without prior assessment by SC, but only if the private debt securities guidelines on transparency have been met. This is in line with SC's disclosure-based regulatory framework for fund raising.


5. Under BNM’s Foreign Exchange Administration Policies, (http://www.bnm.gov.my/microsites/fxadmin/01_fea.htm) proceeds of bond issuances are not to be used for refinancing of offshore borrowing and/or financing of investments abroad exceeding MYR10 million in aggregate in a calendar year. The National Bond Market Committee Negative List, which identifies activities where proceeds from PDS and ABS issuances cannot be used, was repealed on 28 March 2005.

C. Buying debt instruments related regulations / rules (Investment in debt securities)

1. There are no specific regulations restricting retail investors from participating in the Malaysian bond market. Generally, dealers or other intermediaries require a minimum investment amount.

2. To increase trading efficiency, the Securities Commission (SC) liberalized Central Depository System (CDS) account requirements in October 2005, widening the group of those allowed to hold securities on behalf of others. These exempt authorized nominees are now allowed to hold securities in omnibus CDS accounts.

3. SC has a special web site for retail investors—the Malaysian Investor (http://www.min.com.my/). The site provides helpful information on different securities, including bonds.

4. Foreign investors can invest in Malaysian bonds. There are no restrictions on
payments in foreign currency to nonresidents for repatriation of principal, profits, dividends, interest, and commissions.

5. Recent amendments to exchange control regulations enhanced nonresidents' access to domestic credit, and liberalized payments for MYR assets. Nonresident investors of MYR-denominated bonds issued by multilateral development banks and multinational corporations can enter into forward foreign exchange contracts with onshore licensed banks to hedge currency risks. Otherwise, they can only enter into forwards of up to three working days' maturity for settlement purposes.

6. Entities incorporated or registered in the Labuan International Financial Centre (LFX) are declared nonresidents for investment purposes.

D. Investor Protection

1. Bondholders Rights

Bondholder rights are protected under the Companies Act 1965 and Securities Industry Act 1993, and in various amendments.

Under the Companies Act, creditors, including bondholders, can file a winding-up petition for a company when the debtor is unable to pay his debts. When a winding-up order is made, the court appoints a liquidator who oversees the liquidation process.

Foreign creditors have the same rights as local creditors under Malaysian laws.

Under the Securities Industry Act, all bond issuers are required to enter into a trust deed with an appointed trustee. The trust deed contains bond provisions, covenants, and other requirements set by the Securities Commission (SC). The trustee's role is to safeguard the interests of the bondholders as set out in the trust deed and in the Securities Industry Act.

Bond documents (e.g., prospectus, term sheets) also contain covenants and relevant default clauses specific to the bond issue that provide additional protection to bondholders. The SC's website provides copies of term sheets and/or principal terms, and conditions of bond issuances.

2. Prevention of Fraud

False trading, manipulation, and fraud under Division 1 of the Securities Industry Act of 1983 are liable to result in fines and imprisonment. The link below provides comprehensive rules on prohibited conduct and insider trading.

E. Taxation Framework and Tax requirements

Income of any person including a company, accruing in or derived from Malaysia or received in Malaysia from outside Malaysia is subject to income tax.

However, income received in Malaysia by any person other than a resident company carrying on business of banking, insurance or sea or air transport for a year of assessment derived from sources outside Malaysia is exempted from tax.
To modernise and streamline the tax administration system, the self-assessment system was implemented for companies, sole proprietor, partnerships, cooperatives and salaried groups and the assessment of income tax is based on a current year basis.

Non-resident individuals are subject to a final withholding tax of:

10% on special classes of income such as:

a. in consideration of services rendered by the person or his employee in connection with the use of property or rights, installation of or operation of any plant, machinery or other apparatus;
b. in consideration of technical advice, assistance or services rendered in connection with technical management or administration of any scientific, industrial or commercial undertaking, venture, project or scheme;
c. rent or other payments made under any agreement or arrangement for the use of any moveable property

Withholding tax will not be applicable for income received in respect of the services (a) and (b) rendered or performed outside Malaysia.

Effective from 30 August 2008 until 31 December 2012, withholding tax exemption is given to non-residents experts on income received by providing technical training services in the following fields:

a. Post graduate courses in information and communication technology (ICT), electronics and life sciences;
b. Post basic courses in nursing and allied health care; and
c. Aircraft maintenance engineering courses.

Effective from 1 January 2009, to reduce the cost of technical services provided by non-residents, reimbursements or disbursement relating to hotel accommodation in Malaysia will not be included in the computation of gross technical fees for the purpose of withholding tax.

In respect of withholding tax not paid, a penalty of 10% is imposed only on the amount of unpaid tax and not on the total payment made to a non-resident

<table>
<thead>
<tr>
<th>Type of Bonds</th>
<th>Resident Investors and Nonresident Investors</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Interest Income</td>
</tr>
<tr>
<td>Government Bonds and Bills</td>
<td>Exempt from tax.</td>
</tr>
<tr>
<td>Corporate Debt Securities</td>
<td>Exempt from tax.</td>
</tr>
</tbody>
</table>
*It is advisable to verify tax status with relevant authorities or taxation experts before investing in debt instruments listed above.
Source: Federal Treasury of Malaysia

Interest Income Tax

Resident individuals, unit trust companies and listed closed-end fund companies are exempted from income tax for interest income earned from ringgit-denominated Government bonds and private debt securities in Malaysia.

Non-resident investors are also exempted from withholding tax on interest income earned from ringgit-denominated debt securities issued by the Malaysian Government as well as private debt securities approved by the Securities Commission (SC).

Tax Treaties (Double Taxation Avoidance)

Double Taxation Agreement (DTA) is an agreement between two countries seeking to avoid double taxation by defining the taxing rights of each country with regard to crossborder flows of income and providing for tax credits or exemptions to eliminate double taxation.

The objectives of Malaysian DTA are as follows:

i. to create a favourable climate for both inbound and outbound investments;
ii. to make Malaysia's special tax incentives fully effective for taxpayers of capital exporting countries;
iii. to obtain a more effective relief from double taxation compared to relief gained under unilateral measures; and
iv. to prevent evasion and avoidance of tax

Malaysia too cannot absolve herself from the need to facilitate her trade and investments with the outside world through international tax treaty network with other countries. The increased pace of industrialisation coupled with increased foreign direct investment in the country necessitated tax treaty arrangements with other countries to provide investors with certainty and guarantees in the area of taxation.

Stamp Duty

There is no stamp duty relating to the issuance and transfer of Malaysian Government debt securities or private debt securities approved by the SC.

Capital Gains Tax

There is no capital gains tax in Malaysia.

F. Offers of bonds to professionals

G. Definition of “sophisticated investors” in the Malaysia

1. A “sophisticated investor” means a person who fulfils the following criteria:

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4 PRACTICE NOTE 1 issued pursuant to PDS
(a) a person who acquires securities pursuant to an offer, as principal, and the aggregate consideration for the acquisition is not less than RM250,000 or its equivalent in foreign currencies for each transaction whether such amount is paid for in cash or otherwise;

(b) an individual whose total net personal assets exceed RM3 million or its equivalent in foreign currencies; or

(c) a corporation (including an offshore company as defined under the Offshore Companies Act 1990) with total net assets exceeding RM10 million, or its equivalent in foreign currencies, based on the last audited accounts.

2. Section 229 of the Capital Markets and Services Act 2007 ("CMSA") defines excluded offers or excluded invitations and Section 230 defines excluded issues. Both Schedule 6 and Schedule 7 specify certain provisions in Division 3 in regards to the Prospectus shall not apply to “excluded offers” or “excluded invitations”, and “excluded issues” (as set out in Appendix II). An information memorandum issued by a person or his agent purporting to describe the business and affairs of the person in respect of any excluded offer or excluded invitation shall however be deemed to be a prospectus in so far as it relates to the liability of the person or his agent for any statement or information that is false or misleading or from which there is a material omission.

3. According to Schedule 8 of the CMSA, the provisions in Subdivision 1 of Division 4 regarding trust deeds, duties of trustees, borrowers, etc., and Section 283 of the CMSA regarding register of debenture holders, shall not apply to any issue of, offer for subscription or purchase of, or invitation to subscribe for or purchase, debentures specified in Schedule 8 (as set out in Appendix III).

According to Schedule 9 of the CMSA, all the provisions in Division 4 regarding debentures shall not apply to any issue of, offer for subscription or purchase of, or invitation to subscribe for or purchase, debentures specified in Schedule 9 (as set out in Appendix IV).

H. Challenges / Expected changes
III. Trading of Bonds and Trading Market Infrastructure

The Malaysian bond market consists of listed and unlisted bonds. Unlisted bonds are largely traded over-the-counter (OTC) while listed bonds are traded through Bursa Malaysia.

A. Exchange trading

Bursa Malaysia is an exchange holding company approved under Section 15 of the Capital Markets and Services Act 2007. It operates a fully-integrated exchange, offering the complete range of exchange-related services including trading, clearing, settlement and depository services. The wholly-owned subsidiaries of Bursa Malaysia own and operate the various businesses, as set out below:-

<table>
<thead>
<tr>
<th>Subsidiaries</th>
<th>Principal Activities</th>
</tr>
</thead>
<tbody>
<tr>
<td>Bursa Malaysia Securities Bhd</td>
<td>Provide, operate and maintain securities exchange</td>
</tr>
<tr>
<td>Bursa Malaysia Derivatives Bhd</td>
<td>Provide, operate and maintain a futures and options exchange</td>
</tr>
<tr>
<td>Labuan International Financial Exchange Inc.</td>
<td>Provide, operate and maintain offshore financial exchange</td>
</tr>
<tr>
<td>Bursa Malaysia Bonds Sdn Bhd</td>
<td>Provide, operate and maintain registered electronic facility for secondary bond market</td>
</tr>
<tr>
<td>Bursa Malaysia Securities Clearing Sdn Bhd</td>
<td>Provide, operate and maintain a clearing house for the securities exchange</td>
</tr>
<tr>
<td>Bursa Malaysia Derivatives Clearing Bhd</td>
<td>Provide, operate and maintain a clearing house for the futures and options exchange</td>
</tr>
<tr>
<td>Bursa Malaysia Depository Sdn Bhd</td>
<td>Provide, operate and maintain a central depository</td>
</tr>
<tr>
<td>Bursa Malaysia Depository Nominees Sdn Bhd</td>
<td>Act as a nominee for the central depository and receive securities on deposit for safe-custody or management</td>
</tr>
<tr>
<td>Bursa Malaysia Information Sdn Bhd</td>
<td>Provide and disseminate prices and other information relating to securities quoted on exchanges within the group</td>
</tr>
<tr>
<td>Bursa Malaysia Islamic Services Sdn Bhd</td>
<td>Operate all Islamic Markets businesses and activities initiated under Bursa Malaysia</td>
</tr>
</tbody>
</table>

Bursa Malaysia today is one of the largest bourses in Asia with just under 1,000 listed companies offering a wide range of investment choices to the world. Companies are either listed on Bursa Malaysia Securities Berhad Main Market or ACE Market.

In assisting the development of the Malaysian capital market and enhancing global competitiveness, Bursa Malaysia is committed to maintaining an efficient, secure and active trading market for local and global investors.

Detailed information on trading rules and regulations at Bursa Malaysia can be found at http://www.bursamalaysia.com/website/bm/regulation/rules/bursa_rules/

B. OTC market trading

21
Malaysia's OTC market is facilitated by BNM through Fully Automated System for Issuing/Tendering (FAST). It provides information on issue terms, real-time prices, completed trade details, and other relevant news about debt securities. FAST was first launched by Bank Negara Malaysia (BNM) in September 1996 to automate the tendering procedure of Government Securities/Bank Negara Papers, which are issued through the PD network. In July 1997, FAST was further enhanced to include commercial papers and medium term notes which are issued via tender/private placement.
IV. Possible item of Impediments / Restrictions

A. Repo market

B. Liquidity in the secondary market

C. Conclusion
V. High level description of the securities settlement system

A. Securities settlement infrastructure

Sovereign and unlisted corporate bonds are registered, cleared, and settled through BNM’s real-time, gross-settlement, delivery-versus-payment system, RENTAS. RENTAS membership is restricted to financial institutions licensed under the Banking and Financial Institutions Act 1989. All unlisted corporate bonds are held by BNM as a custodian agent and are settled by fund exchange.

All listed corporate bonds under the Bursa Malaysia are held in book-entry form and cleared and settled through the Bursa Malaysia Securities Clearing Sdn. Berhad (formerly Securities Clearing Automated Network Services Sdn. Berhad [SCANS]). Bursa Malaysia also offers settlement services to institutional investors through the Institutional Settlement Service of Bursa Malaysia Securities Clearing Sdn. Berhad.

The Bursa Malaysia Depository Sdn. Berhad (formerly the Malaysian Central Depository Sdn. [MCD]) operates a system for the central handling of securities that facilitates securities transactions without the physical delivery of scrip. The Bursa Malaysia Derivatives Clearing Berhad (formerly the Malaysia Derivatives Clearing House Sdn, Berhad [MDCH]) provides clearing and settlement services for the futures market operated by the Bursa Malaysia Derivatives Berhad (formerly the Malaysia Derivatives Exchange [MDEX]).

The clearing and settlement of contracts executed under Bursa Malaysia’s two exchanges (securities and derivatives exchanges) are based on the Fixed Delivery and Settlement System (FDSS). Settlement is on a T+3 basis. The financial settlement of securities is done on a net—rather than gross—basis.

B. Definition of Clearing and settlement

1. Clearing

a. “Clearing” means the process of exchanging and reconciling payment items that result in the establishment of final positions for Settlement.⁵

b. “Clearing facilities” means a facility for the clearing or settlement of transactions in securities traded on a stock exchange or futures contracts traded on a futures market; a facility for the guarantee of settlement of transactions; or such other clearing or settlement facility or class of clearing or settlement facilities as the Commission with the approval of the Minister may allow.

c. “Clearing house” means a person whose activities or objects include the provision of clearing facilities.

d. The clearing house is the Bursa Malaysia Securities Clearing Sdn. Bhd.

Rules of Bursa Malaysia Securities Clearing can be found at this link: http://www.bursamalaysia.com/website/bm/regulation/rules/bursa_rules/downloads/

⁵ Participation and Operation Rules of Services provided by MyClear issued by Bank Negara Malaysia dated 6 May 2011
2. Settlement

Based from CMSA, settlement, in relation to a market contract, means the discharge of the rights and liabilities of the parties to the market contract whether by performance, compromise or otherwise; and includes partial settlement effected in accordance with the rules of an approved clearing house.

a. All securities trades are generally settled based on a delivery-versus-payment (DvP) basis. For all government and securities and scripless corporate debt securities, ownership and transfers are reflected as book-entries in the custody accounts with BNM in Real Time Electronic Transfer of Funds and Securities (RENTAS).

b. The settlement of the primary and secondary market transactions in government securities and unlisted corporate debt securities take place through the Scripless Securities Trading System (SSTS), which is part of the RENTAS system.

c. USD-denominated debt securities and sukuk will be settled in RENTAS on DvP basis while those denominated in other foreign currencies may be settled on a non-DvP basis.

d. Scripless securities, including Malaysian government securities and selected debt securities and sukuk, can also be settled internationally via major global custodian banks and international central securities depositories, such as Euroclear and Clearstream.


C. Challenges/ Expected changes
VI. Cost and charging methods

The following market charges exist in the Malaysian Market

<table>
<thead>
<tr>
<th>Market Charge</th>
<th>Details</th>
</tr>
</thead>
<tbody>
<tr>
<td>Brokerage Fees</td>
<td>Fully negotiable</td>
</tr>
<tr>
<td>Clearing Fees</td>
<td>To be determined by the Clearing House from time to time</td>
</tr>
<tr>
<td>System Maintenance</td>
<td>To be determined by the Exchange from time to time</td>
</tr>
<tr>
<td>Fees</td>
<td></td>
</tr>
</tbody>
</table>

Details on the market charges can be found on this link: http://www.bursamalaysia.com/website/bm/regulation/rules/bursa_rules/downloads/bm_brchapter10.pdf
VI. Market size / statistics

A. Market size

Total outstanding local currency (LCY) bonds in Malaysia increased 18.9% y-o-y to MYR755.3 billion as of end-December. Outstanding LCY government bonds jumped 28.5% y-o-y to MYR445.6 billion, mainly due to the increase in outstanding central bank bills. Excluding central bank bills, outstanding government LCY bonds rose by 9.8% y-o-y. LCY corporate bonds outstanding, on the other hand, posted 7.4% y-o-y growth. More information can be found at the Asianbondsonline website (www.asianbondsonline.adb.org).

B. Sukuk market

Reflecting the government's effort to boost Malaysia's Islamic capital market, Islamic-based LCY government and corporate bonds outstanding have been steadily increasing for the past decade, amounting to MYR113.5 billion and MYR180.6 billion, respectively, at end-2010. Moreover, Islamic medium-term notes (MTNs) rose by 14.8% to reach MYR101.5 billion, while the stock of more traditional Islamic bonds issued by corporations (IBONDS) declined to MYR68.8 billion. Islamic corporate paper rose to MYR5.3 billion in 2010, while Islamic asset-backed securities dropped to MYR 5.1 billion. More information can be found at the Asianbondsonline website (www.asianbondsonline.adb.org).

C. Equity market

Market capitalisation advanced strongly, crossing MYR1 trillion threshold on the first trading day of 2010, and rounded off the year by growing by some 28% over the year. IPO activity contributed to a strong year-end boost in overall market values.
VIII. Presence of an Islamic Finance (Islamic bond (Sukuk)) market

A. Regulatory framework for Islamic Finance in general

Malaysia is at the forefront of Islamic finance. It is the largest issuer of Islamic financial products in East Asia. The Securities Commission of Malaysia supervises the Islamic Capital Market (ICM), which operates parallel to conventional capital markets. ICM plays a complementary role to the Islamic banking system by broadening and deepening instruments and access to Islamic financial markets. Malaysia is also host to the Islamic Financial Services Board (IFSB).

B. Type of instruments available, segments, tenure, e.g.

The conventional government bonds have counterpart Islamic debt securities (also called sukus). These are:

1. Bank Negara Monetary Notes-i (BNMNs-i) are Islamic securities issued by BNM to manage liquidity in the Islamic financial market that have also replaced Bank Negara Negotiable Notes.
2. Malaysian Islamic Treasury Bills (MITBs) are short-term securities based on Islamic principles issued by BNM on behalf of the government. The structure of MITB is based on the *bai’al-inah* (sell and buy-back agreement) principle and are actively traded based on the *bai’ ad-dayn* (debt trading) principle in the secondary market.
3. Government Investment Issues (GIIs) are non-interest-bearing government securities based on Islamic principles issued by the government and placed on a competitive tender with 3–10 year maturities. Like MGSs, GIIs are issued by BNM on behalf of the government and the funds are used for development expenditures.
4. Sukuk Bank Negara Malaysia Issues (SBNMIs) are zero coupon bonds with maturities of 1–2 years. SBNMI are based on *al-ijarah* (sale and lease back) principle.
5. Merdeka Savings Bonds A bond structure based on Shariah principles with the purpose of providing assistance to retirees who depend primarily on interest income from deposits placed with the banking institutions.
6. Sukuk 1Malaysia 2010 Sukuk 1Malaysia 2010 which is based on Shariah principles, is an additional investment instrument for Malaysian citizens who are 21 years and above. Sukuk 1Malaysia 2010 has a resaleable feature which provides the flexibility for investors to sell and purchase the sukuk before the maturity date.

Corporates also issue sukuks. In fact, the corporate sukuk market has grown exponentially in recent years, with an annual average growth of 21% between 2001 and 2008. Corporate sukuk currently account for 55.9% of the outstanding corporate debt securities and sukuk issued in Malaysia.

C. Basic Market infrastructure required to facilitate Islamic Finance (Islamic bonds: Sukuk)

Basically, the market infrastructure is the same for both conventional and Islamic securities. Below is the diagram to illustrate:
D. Tax related issues

Profits and dividends received by non-resident investors from holding of ringgit and non-ringgit Islamic instruments issued in Malaysia are exempted from withholding tax. Special Purpose Vehicles (SPV) for Islamic financing purposes via the Islamic capital market are not subject to the administrative procedures under the Income Tax Act 1967. In addition, companies that establish these SPVs are given a tax deduction on the issuance cost of the Islamic securities incurred by the SPV. The issuance cost for all Islamic securities approved by the Securities Commission are also eligible for tax deduction. Finally, there is a stamp duty exemption on instruments relating to Islamic securities under the MIFC until 2015.
IX. History of Debt Market development

During the 1970s and 1980s, the government issued Malaysian Government Securities (MGSs) to finance the public sector’s development. Later, MGSs were issued to fund the fiscal deficit and refinance a portion of the government’s external debt. Even in periods when fiscal surpluses were posted, the government continued to issue MGSs to meet market demand. Other the other hand, shari'a-based Government Investment Issues (GIIs) and Malaysian Islamic Treasury Bills (MITBs) were issued to provide liquid instruments that satisfy Islamic banks’ statutory liquidity requirements.

Securitization in Malaysia began in 1986 when the government established the National Mortgage Corporation (Cagamas), the largest issuer of securitized instruments in Malaysia. Khazanah Berhad and Cagamas Berhad soon became major issuers of quasi-government bonds. Khazanah Bonds were originally issued not to raise fund for capital or to finance projects, but for the specific purpose of serving as a benchmark for Islamic corporate bonds. Issuance of this original type of Khazanah bonds, however, has not occurred since 2006, and the outstanding amount of these bonds has fallen precipitously. More recently, Khazanah and Cagamas have been issuing corporate bonds and medium-term notes, both of which are classified as corporate instead of quasi-government bonds.
X. Next Step → Future Direction

A. Future Direction

B. G-30 Compliance

<table>
<thead>
<tr>
<th>Recommendation</th>
<th>Implemented</th>
</tr>
</thead>
<tbody>
<tr>
<td>1 Eliminate paper and automate communication, data capture, and enrichment.</td>
<td>No All unlisted debt securities are dematerialised, except for some CP/MTN programmes issued before April 2006</td>
</tr>
<tr>
<td>2 Harmonize messaging standards and communication protocols.</td>
<td>No CSD and most local market participants do not use SWIFT message formats</td>
</tr>
<tr>
<td>3 Develop and implement reference data standards.</td>
<td>Yes ISIN codes are available for all local bond issues, and are available at the time of issue.</td>
</tr>
<tr>
<td>4 Synchronize timing between different clearing and settlement systems and associated payment and foreign exchange systems.</td>
<td>Yes</td>
</tr>
<tr>
<td>5 Automate and standardize institutional trade matching.</td>
<td>Yes</td>
</tr>
<tr>
<td>6 Expand the use of central counterparties.</td>
<td>No</td>
</tr>
<tr>
<td>7 Permit securities lending and borrowing to expedite settlement.</td>
<td></td>
</tr>
<tr>
<td>8 Automate and standardize asset servicing processes, including corporate actions, tax relief arrangements, and restrictions on foreign ownership.</td>
<td></td>
</tr>
<tr>
<td>9 Ensure the financial integrity of providers of clearing and settlement services.</td>
<td>Yes</td>
</tr>
<tr>
<td>10 Reinforce the risk management practices of users of clearing and settlement service providers.</td>
<td>Yes</td>
</tr>
<tr>
<td>11 Ensure final, simultaneous transfer and availability of assets.</td>
<td>Yes</td>
</tr>
<tr>
<td>12 Ensure effective business continuity and disaster recovery planning.</td>
<td>Yes</td>
</tr>
<tr>
<td>13 Address the possibility of failure of a systematically important institution.</td>
<td></td>
</tr>
<tr>
<td>14 Strengthen assessment of the enforceability of contracts.</td>
<td>Yes</td>
</tr>
<tr>
<td>15 Advance legal certainty over rights to securities, cash, or collateral.</td>
<td>Yes</td>
</tr>
<tr>
<td>16 Recognize and support improved valuation methodologies and closeout netting arrangements.</td>
<td>Yes</td>
</tr>
<tr>
<td>17 Ensure appointment of appropriately experienced and senior board members (of the boards of securities clearing and settlement infrastructure providers).</td>
<td>Yes</td>
</tr>
<tr>
<td>18 Promote fair access to securities clearing and settlement networks.</td>
<td>Yes</td>
</tr>
<tr>
<td>19 Ensure equitable and effective attention to stakeholder interests.</td>
<td>Yes</td>
</tr>
<tr>
<td>20 Encourage consistent regulation and oversight of securities clearing and settlement service providers.</td>
<td>Yes</td>
</tr>
</tbody>
</table>

C. GOE Barrier Report Market assessment - Malaysia
<table>
<thead>
<tr>
<th>Potential barrier area</th>
<th>Current situation</th>
<th>Market Assessment Questionnaire scores</th>
<th>Overall barrier assessment</th>
</tr>
</thead>
<tbody>
<tr>
<td>Quotas</td>
<td>There are no quotas on foreign involvement in the local market.</td>
<td>OK</td>
<td>OK</td>
</tr>
<tr>
<td>Investor registration</td>
<td>There are no foreign investor registration requirements.</td>
<td>OK</td>
<td>OK</td>
</tr>
<tr>
<td>FX controls - conversion</td>
<td>There are no exchange control restrictions on residents or non-residents. HKD is freely convertible.</td>
<td>OK</td>
<td>OK</td>
</tr>
<tr>
<td>FX controls - repatriation of funds</td>
<td>There is no restriction on the repatriation of funds.</td>
<td>OK</td>
<td>OK</td>
</tr>
<tr>
<td>Cash controls - credit balances</td>
<td>Non-residents may open accounts in HKD or in foreign currency. Credit balances are allowed.</td>
<td>OK</td>
<td>OK</td>
</tr>
<tr>
<td>Cash controls - overdrafts</td>
<td>Overdrafts are allowed.</td>
<td>OK</td>
<td>OK</td>
</tr>
<tr>
<td>Taxes</td>
<td>There is no withholding tax on any financial instrument. There is no capital gains tax.</td>
<td>OK</td>
<td>OK</td>
</tr>
<tr>
<td>Omnibus accounts</td>
<td>Omnibus accounts are allowed.</td>
<td>OK</td>
<td>OK</td>
</tr>
<tr>
<td>Settlement cycle</td>
<td>The settlement cycle is T+2 for listed debt securities.</td>
<td>OK</td>
<td>OK</td>
</tr>
<tr>
<td>Message formats</td>
<td>CMU uses SWIFT for settlement messages, and plans to introduce SWIFT for corporate events messages from November 2009. Most local market participants use SWIFT format.</td>
<td>OK</td>
<td>OK</td>
</tr>
<tr>
<td>Securities numbering</td>
<td>ISIN are available for most local bond issues. ISIN are allocated at the time of issue or auction. CMU and local market participants use ISIN, but the local numbering (CMU Issue Number) is also commonly used.</td>
<td>OK</td>
<td>OK</td>
</tr>
<tr>
<td>Matching</td>
<td>There is no trade matching system for the local bond market. CMU pre-matches forward dated settlement instructions.</td>
<td>LOW</td>
<td>LOW</td>
</tr>
<tr>
<td>Dematerialisation</td>
<td>All fixed income instruments are either dematerialised or immobilised at the CSD.</td>
<td>LOW</td>
<td>LOW</td>
</tr>
<tr>
<td>Regulatory framework</td>
<td>The regulatory regime is regarded as stable and consistent and no adverse comments were received in this area.</td>
<td>-</td>
<td>OK</td>
</tr>
</tbody>
</table>
Contributors to the making of this market guide

- Securities Commission Malaysia (http://www.sc.com.my/)
- Bond Info Hub (www.bondinfo.bnm.gov.my)
- AsianBondsOnline website (www.asianbondsonline.adb.org)
ABMF SF-1

Thailand Bond Market Guide

Version: No.4_20/June/2011
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   C. Brief history of the development of the Securities settlement infrastructure
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IX. History of Debt Market development

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I. High Level Structure, Type & Characteristics of the Market

Thailand’s bond market has developed significantly since the 1997/98 Asian financial crisis, with increased bond issuance and an actively-traded local market.

The Ministry of Finance (MOF) has stepped up issuance of government bonds for its financing requirements and to build a reliable yield curve in support of market-risk pricing. Government bonds still dominate the market.

Since the late 1990s, both government and corporate issuers have used bonds to raise capital. However, the issues are generally straight fixed-rate or floating-rate notes. The structured bond market is still in the early stages of development.

A. Overview

1. Background

The Thai bond market has grown rapidly in recent years after the 1997’s economic crisis. To help support cash-strapped financial institutions, in June 1998 the government issued government bonds for the first time in the decade. The total amount of government bonds issued under that program was THB 500 billion and this has opened a new era for the Thai bond market.

The government continued to issue bonds since then with the primary objective to finance budget deficit resulted from the crisis.

The substantial amount of new government bonds coupled with successively downtrend of interest rates have contributed to the robust of the bond market as evidenced by a significant increase in both market size and trading volume.

Government bonds still dominate the market, making up about 80% of all bonds issued. With the introduction of regulations governing corporate bond issuance, a variety of issuers have entered the market, including multinationals, supranational, and local companies.

Both government and corporate bonds are available with tax waivers to foreign investors.

Bond trading is conducted either over-the-counter (OTC) or via the Bond Electronic Exchange (BEX) for retail bonds, which was established by the Stock Exchange of Thailand (SET) in November 2003.

All OTC trades are reported to the Thai Bond Market Association (Thai BMA) for posting.

2. Regulatory Environment

The Bank of Thailand (BOT) supervises the operation of banking and finance

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1 Overview of Bond markets in Thailand is provided in [http://www.thaibma.or.th/main.html](http://www.thaibma.or.th/main.html) select “Bond Tutorial” and then “Bond Market Overview”, and the attached file “FSAP_Fixed Income Markets 2008”. IMF paper which contain a history and background on Thai Bond Market,"
businesses while the Securities and Exchange Commission (SEC) supervises the primary and secondary market for securities business.

The issuance and offering of securities are governed by the Securities and Exchange Act 1992 (B.E. 2535).

In November 1994, ‘the Bond Dealers Club’ was set up to be the secondary market for debt securities. The BDC was upgraded to “The Thai Bond Dealing Centre (Thai BDC)” in April 1998 after it was granted the “Bond Exchange” license from the SEC.

The Thai BDC goals were to provide an environment for fair and secure trading, to monitor trade and to disseminate information on the secondary bond market.

The Thai BDC also functioned as a self-regulatory organization (SRO) and has implemented a number of standards and conventions for bond trading.

ThaiBDC had continuously expanded its functions and had taken active roles in various area of bond market development.

In December 2004, the Bond Market Development Committee chaired by the Finance Minister initiated a major reform of the Thai bond market.

One of the measures was to centralize the trading platform at the Stock Exchange of Thailand (SET) while ThaiBDC would remain and expand its functions as the SRO and information center for the bond market.

Under this policy, ThaiBDC has sold its newly developed electronic trading platform to the SET in 2005.

And to reiterate its focus on SRO functions and information center, ThaiBDC with the support from SEC has changed its status and was granted the license of a securities related association under the SEC Act named as “The Thai Bond Market Association (ThaiBMA)” on September 8, 2005.

As “Bond Pricing Agency”, ThaiBDC also provides model yield and pricing data for mark-to-market purpose of investors such as mutual funds. This is deemed very useful in the case of illiquid debts securities.

B. Types of Bonds

Products in Thai bond market are stated as follows.

1. Thai Government Debt Securities (TGSs):

The TGSs are the securities issued by the Thai government. Legally authorised, the Ministry of Finance (MOF) acts as bond issuer for fund mobilization from investors and general public to fund public expenditures such as budget deficit, losses incurred by the Financial Institutions Development Fund, refinancing, and infrastructure funding.

Recently, MOF revised the Public Debt Management Act to allow government to issue government bonds for 2 additional purposes: to on-lend to other government agencies and to develop domestic bond market.

Government securities, which may also be traded through the BEX, settle on a gross,
trade-by-trade basis via the PTI system. The timing of the settlement process varies
according to whether the trade was executed through the Account Order Matching
(AOM) system or the Put Through (PT) system for large-lot trades valued greater than
THB3million.

For AOM trades, the TSD checks to ensure there are securities available in the selling
member’s account by SD 13:30. The TSD prepares and sends payment details to the
BOT.

The BOT receives payment details, credits or debits custodian banks’ cash accounts,
and generates a confirmation of debits/credits to the TSD.

Once the TSD receives, between 13:30 and 14:00, confirmation from the BOT, the
TSD immediately credits/debits securities to/ from the member accounts in the PTI
system.

For PT trades, the process is essentially the same; however, availability of securities
for delivery is assessed at 10:00 and securities are credited / debited between 10:00
and 11:00.

The TGSs currently issued can be classified into 2 main groups: Treasury Bills and
Government Bonds.

a. Treasury Bills (T-Bill):

   Treasury Bills refer to debt securities with maturity not longer than 1 year. Currently,
   the government has made short-term borrowing by auction of Treasury bill with
   maturity periods of 1, 3 and 6 months with the auction size of 2,000 to 10,000 million
   Baht.

   Bearing no interest, they are auctioned at a discount but redeemed at par value at
   maturity.

   Treasury Bills are issued in minimum denominations of THB 1000.

   They are issued through competitive bidding via the BOT on a weekly or fortnightly
   basis (basically every Monday) depending on the demand for short-term capital.

b. Government Bonds:

   Government Bonds are generally issued for a fixed term longer than 1 year.

   According to the Public Debt Management Act B.E. 2548 (A.D.2005), bonds are
   defined as debt instruments pertaining to long-term obligation of over 12 months.
   TGBs usually denominated in units of 1,000 Baht.

   All government bonds (except for the 4-year floating rate bond that issued in May
   2009) are the bonds with fixed rate coupons.

   The interest rate payment will be calculated semi-annually and the principal amount
   is repaid once at maturity.

   Generally, they can be categorised into 2 main characters: Investment Bonds or
   Loan Bonds and Saving Bonds.
i. Loan Bonds (LBs)

Loan Bonds (LBs) are bonds that target institutional investors. Currently, Thai government has issued LBs with maturities between 1 to 30 years. Of which 5- and 10-year bonds are issued as benchmark bonds in order to increase liquidity in secondary market. The auction will be held on Wednesday.

In fiscal year 2009, the Public Debt Management Office (PDMO) issued 5-year benchmark bonds with the auction size of 10,000 to 15,000 million Baht every even month and 10-year benchmark bonds with the auction size of 10,000 to 13,000 million Baht every odd month. In addition, the 15- and 20-year bonds were issued regularly in order to create reference rate for domestic bond market and to match the investment portfolio of long term investors.

Since the year 2008, the 30-year bonds has been issued, which are aimed to the insurance companies. The main objective of the 30-year bonds is to decrease the mismatch of the insurance company's portfolio. During the start-up period, the size of this bond is pretty small as a part of the price discovery process in order to get the full market competition in the future. In the long run, the government plan to use these 30-year bonds as an instrument for mega-project funding.

Recently, the Public Debt Management Office (PDMO) issued the 4-year Floating Rate Bond (FRB) which has variable coupon rate, equal to Bangkok Interbank Offered Rate (BIBOR rate) plus a spread. The spread is a rate that remains constant. The interest rate payment will be calculated semi-annually by taking the fixing of the BIBOR rate for that day and adding the spread. The principal amount is repaid once at maturity.

There are three groups of issuing bodies of government securities namely Ministry of Finance (MOF), the Bank of Thailand (BOT) and State Owned Enterprises (SOE).

Meanwhile, there are four types of government securities which are Treasury Bills (T-Bill), Government Bonds: Loan bonds (LB) and Saving Bonds (SB), State agency bonds (i.e. BOT bonds), and State-owned Enterprise bonds (SOE bond).

ii. Saving Bonds (SB)

Saving Bonds (SB) are government bonds that target the retail investors. The minimum purchase for each investor is set at 10,000 Baht, with the total value purchased to be in multiples of 10,000 Baht. In most issues, retail investors are allowed to submit one purchase subscription for each tranche with a maximum investment of 500,000 Baht. Interest on the bonds is paid at a fixed rate twice a year.

Eligible buyers include individuals who are Thai nationals or residents, and...
non-profit institutions such as foundations, the Thai Red Cross Society, and the National Council on Social Welfare of Thailand.

The savings bonds are sold through selling agents appointed by the MOF such as commercial banks and Government Saving Bank, while the Bank of Thailand (BOT) is responsible for supervising the sales, ownership registration and issuing the physical bond certificate.

2. Corporate Bonds

Generally, corporate bonds are traded through the Bond Electronic Exchange (BEX) or OTC. Clearing and settlement is facilitated by dealers or by the TSD’s multilateral netting system under the TSD’s net clearing process.

Bond transactions are pre-matched by telephone and settlement occurs via the PTI system, following the same process as equities.

However, unlike equities, settlement of bonds occurs on T+2.

The more commonly traded unlisted debt issues are bills of exchange (BEs) and short-term negotiable certificates of deposits (NCDs). Settlement details for BEs and NCDs are negotiated between counterparties.

Authentication is a critical component of the settlement process of unlisted debt, as no standardized treatment for settlement exists.

Payment is made by check or BAHTNET subsequent to the sub-custodian’s verification that the BEs or NCDs have been received in good form and are authentic.

Corporate Bonds comprise of:

a. Long-term Corporate Bonds:
   Bonds issued by corporate sector with tenors of 1 year and over.

b. Commercial Papers:
   Short-term debt instruments including bill of exchange and short-term debentures. Normally commercial paper has maturity less than 270 days.

c. Structured Bonds:
   These are bonds with the following features.

   i. The amount of return is linked with a predetermined underlying variable other than interest rate.

   ii. Total or partial amount for principal is linked with a predetermined underlying variable e.g. equity price/index, gold price, FX. Commodity price/index and credit rating.

d. Foreign Bonds:
   Since 2005, MOF has allowed certain types of foreign institutions to issue Baht denominated bonds in Thailand. They include International financial intuitions, foreign government, financial institutions of foreign governments and foreign entities e.g. ADB, JBIC, KFW, etc.
e. Foreign denominated bonds:
   In 2010, Thai entities are allowed to issue bonds in foreign currency. Currently there is only 1 company issuing this type of bonds.

C. Money Market Instruments

Money market instruments are traded in OTC market and settled by physical delivery. There are various Money Market Instruments traded in Thai Capital Market;

1. Promissory Notes

   PNs are physical, bearer instruments issued by banks and other financial institutions. PNs are issued on a discounted basis with tenures ranging from one month to one year.

2. Bills of Exchange /

   Bills of Exchange are similar to cheques and promissory notes, which sometimes are referred to as a “draft”. They can be drawn by individuals or banks and are generally transferable by endorsements.

   The difference between a promissory note and a bill of exchange is that this product is transferable and can bind one party to pay a third party that was not involved in its creation.

3. Commercial Papers

   Commercial Paper is a short-term unsecured note issued by corporation. The maturity of CP is less than 270 days.

   The most common form of commercial paper are taking the Bills of Exchange (BE) format, which are short term THB denominated interest bearing or discounted instruments.

   BE are issued in bearer or registered form by banks, companies and other financial institutions.

   Typical issue sizes range from THB 5-250million, and tenures vary. I.E. between one month to one year.

4. Time Deposits (Short term Negotiable Certificates of Deposit (NCD))

D. Segmentation of the Market (Market outstanding by Market Type)

   Breakdown or Segmentation of the Market is as follows.

   1. Government Debt Securities\(^2\)  81% of total outstanding value
   2. Corporate Bond  16%

\(^2\) Treasury Bill / Bank Of Thailand (BOT) Bond / Government Bond / State Owned Enterprise Bond
3. Commercial Paper  2%
4. Foreign Bond  1%

See information in the attached file (?) named “Survey on Primary Market Questions for IOSCO Jurisdictions”

E. Listing of Debt securities

1. Listed securities

“Listed Securities” means debt instruments listed or authorized to trade on the Exchange (SET/BEX); Issuer should get approval from the Exchange for listing.

All government and corporate bonds publicly offered are listed in Thailand.

See:
SET/BEX’s rules related to bond listing below.
http://www.set.or.th/set/notification.do?idLv1=7&idLv2=57&language=en&country=US
REGULATIONS OF THE STOCK EXCHANGE OF THAILAND
Re: Listing of Debt Instruments as Listed Securities, 2004
SET/BEX explanation about bonds listing
Extracts from "Background of Thai Bond Market”

2. SET/BEX Listed and Publicly Offered Bonds

The information regarding the periodic interest rates, frequency of the coupon payments, term to maturity, par value of the bond, redemption value of the bond and any other provisions are all stated in the prospectus when a bond is issued.

Once a bond is auctioned off the primary market, the bond can be electronically traded in the secondary market, Bond Electronic Exchange (BEX).

There are several names associated with bond, such as debt instrument, fixed income instrument, debenture, etc.

Investors (mainly retail investors) can buy/sell bond in Bond Electronic Exchange (BEX), which has been officially launched on November 26th, 2003.

BEX’s primary goal is to develop all facets of the Thai bond market to reach an international standard, on par with other mature bond markets in the rest of the world. In addition, the institution of an electronic trading platform like BEX is a step of progress towards creating a vibrant Asian Bond Market, whose development and progress would contribute to the stabilization of the regional economy.

Having said that the Thai Bond market is OTC focused, 95% of trades are done OTC bases.

F. Methods of Issuing Bonds (Primary Market)

1. Bond Issuance procedure

Once an issuer decides to issue bonds, financial advisor will be appointed in helping to provide opinions on the type, conditions, and other relevant details of bond issuance.
The financial advisor helps in preparing all the necessary documents regarding the bonds being issued in order to obtain SEC’s permission.

Then, the advisor will go through the course of getting the bond rated by one of the two SEC’s approved rating agencies. (Rating is mandatory in Thailand)

In addition, the company must appoint an underwriter who will allocate the bond to investors after receiving the SEC’s approval.

In some cases, issuers may decide to go through the process without the help of a financial advisor or underwriter.

2. Government Securities Offering Method

Most of government securities are issued through auction method except for SOE bonds which are offered through underwriters.

Units which run the auction for government securities are Bank of Thailand (BOT) and the Public Debt Management Office (PDMO).

The BOT is responsible for the auction of T-Bills, Loan Bonds, and BOT Bonds while PDMO is responsible for SOE Bonds in both categories; with and without government guarantee.

The Bank of Thailand has set up a bidding system for government securities comprising two types:

a. Competitive Bidding - Eligible participants are required to submit a bidding form through electronic channel (e-Bidding) within 9.30 am on the auction date. A bidder should indicate the desirable size and yield with a minimum amount of THB 100 million.

b. Non-Competitive Bidding - Those who are interested in this kind of bidding has to submit subscription forms to primary dealers by 12.00 am on a day prior to the auction date. The primary dealer then gathers all the forms and submits to the Bank of Thailand by 2.00 pm on same the day. Bidders indicate only the size they prepare to take which should be between THB 4-40 million.

With regards to SOE Bond auction, PDMO usually calls for bid among underwriters on a full commitment basis. Bidders should submit underwriting proposal detailing yields, fees and all other expenses together with names of related parties. Bidding result is posted on PDMO website approximately 11.am on the auction date. SOE Bonds are offered though underwriting mechanism.

3. Corporate Bond Offering Method

Bond offering in private sector is divided into two categories: Public Offering and Private placement offering.
Corporate bonds are usually sold under underwriting process.

4. SEC Act — Approval for the Offering of Newly-Issued Securities
Chapter 2 Issuance of Securities
Division 1 Approval for the Offering of Newly Issued Securities
http://www.sec.or.th/laws_notification/Content_0000000312.jsp?categoryID=CAT0000015&lang=en
G. Public Offering Market / Private Placement Market

1. Two types of bond offerings

There are two types of bond offerings.

a. Private placement (PP)

Ref. Characteristics of Private Placement (below)

The first one is private placement (PP), where the offer is made to fewer than 10 investors or the issue size is less than 100 million Baht. (This part is Exchange Rule)

The bonds are offered to a limited group of investors, particularly institutional investors.

There is a condition in the secondary market that only allows institutional investors to buy and sell these bonds.

This type of bond is negotiated and trade off the Exchange floor, referred to as an “Over-the-Counter (OTC).”

<table>
<thead>
<tr>
<th>Characteristics of Private Placement</th>
</tr>
</thead>
<tbody>
<tr>
<td>Notification of the Capital Market Supervisory Board No. TorChor. 9/2552</td>
</tr>
<tr>
<td>Re: Application for and Approval of Offer for Sale of Newly Issued Debt Securities</td>
</tr>
<tr>
<td><a href="http://capital.sec.or.th/webapp/nrs/data/4607se.pdf">http://capital.sec.or.th/webapp/nrs/data/4607se.pdf</a></td>
</tr>
<tr>
<td>Chapter 2 Private Placement of Debt Securities</td>
</tr>
<tr>
<td>Division 1 Characteristics of Private Placement</td>
</tr>
</tbody>
</table>

Clause 32 An offer for sale of bonds in any of the following manners shall be deemed private placement:

(1) An offer made to institutional investors or high net worth investors, excluding an offer made to institutional investors or high net worth investors with registration of transfer restriction among not exceeding ten investors within any four-month period which shall fall under (2);

(2) An offer made specifically to not exceeding ten investors within any four-month period;

In cases where the securities depository center, custodian, securities broker, securities dealer or any person holds bonds on behalf of other persons, the counting of the number of investors under the first paragraph shall be based on the real owner of such bonds.

(3) An offer made to the person being the company’s creditor prior to the offer for sale of bonds for the purpose of debt restructuring;

(4) An offer granted an exemption from the Office, where the approved person shall demonstrate that:

(a) There is reasonable and appropriate cause;
(b) Such offer for sale shall not affect investors at large; and
(c) There are sufficient measures for investor protection.

Clause 33 In case of requesting an exemption for an offer for sale of newly issued bonds under Clause 32(4), the person requesting an exemption shall demonstrate the reasonable and appropriate cause of such case, the non-existence of effects on investors at large and the availability of sufficient measures for investor protection, and the Office may grant an exemption for application of the rules or conditions prescribed in this Chapter, whether totally or partially, to such offer for sale of bonds as deemed necessary, by taking into account the suitability and sufficiency of measures for investor protection.

Clause 34 Bills issued in any of the following manners shall be deemed issuance of bills for private placement:

(1) Bills issued by the securities finance institution or any other person as specified by the Office with the purpose to borrow money from institutional investors or high net worth investors;

(2) Short-term bills offered to institutional investors or high net worth investors;
(3) Bills which do not fall under (1) or (2) in the amount of not exceeding ten bills at any time when counting all types of bills issued by the company.

For the purpose of the provisions in this Clause, the term “institutional investor” under the first paragraph shall not include the persons prescribed in Clause 5(3) of the Notification of the Securities and Exchange Commission No. KorChor. 4/2552 Re: Exemption from Filing of Registration Statement for Offer for Sale of Debt Securities dated 13 March 2009.

Division 3 After-Approval Conditions for Private Placement of Debt Securities

Clause 37 In case of an offer for sale of all types of newly issued debt securities to institutional investors established under Thai law or high net worth investors under Clause 32(1), the approved person shall comply with the conditions under Clause 38, Clause 39 and Clause 40.

Clause 38 Prior to each offer for sale of newly issued debt securities, the approved person shall provide any of the following credit rating arrangement by the credit rating agency approved by the Office:

(1) Credit rating of debt securities offered for sale each time (issue rating);

(2) Credit rating of the debt securities guarantor (guarantor rating), only in cases where the guarantor is obliged to liabilities jointly with the debtor without revocability before the debt securities maturity, including credit rating of the provider of aval of principle and interest of bills in full amount without condition; or

(3) Credit rating of the approved person (issuer rating), excluding the case of an offer for sale of subordinated bonds.

The provisions related to granting of exemption for credit rating arrangement as prescribed in the second paragraph of Clause 21 shall also apply to the case under the first paragraph.

Clause 39 After the issuance of debt securities, the approved person shall provide continuous arrangement of credit rating of debt securities in accordance with the rules under Clause 38 until the claim for repayment of such debt securities is terminated. Except where it is necessary and appropriate, the Office may grant an exemption for arrangement of credit rating of debt securities and may also prescribe the timeframe or conditions thereof, by taking into consideration the necessity of credit rating information for investors.

Clause 40 The approved person shall file an application with the Thai Bond Market Association for registration of the issued and offered debt securities within thirty days after the issuing date.

Clause 41 In case of an offer for sale of short-term bonds or bills to institutional investors or high net worth investors, the approved person may make unlimited offer for sale of short-term bonds or bills subject to the registration statement filed for an offer for sale of short-term bonds or bills to institutional investors or high net worth investors as prescribed in the Notification of the Capital Market Supervisory Board concerning filing of registration statement for offer for sale of debt securities, but any offer shall be made within one year after the effective date of such registration statement.

Division 4 Additional After-Approval Conditions for Private Placement of Bonds

Clause 42 Prior to an offer for sale of bonds, the approved person shall obtain an explicit resolution from the company’s board of directors approving the issuance of bonds. Except where the applicant is a public limited company, the resolution for the issuance of bonds shall be obtained in compliance with the law on public limited company.

The provisions in the first paragraph shall not apply to the case where the company is required to issue bonds according to the rehabilitation plan under the bankruptcy law which has been approved by the court, or any other case granted an exemption by the Office.

Clause 43 In case of secured bonds or bonds provided with the bond holder representative, the approved person shall provide the bond holder representative whose name is in the list of persons qualified to be the bond holder representative in accordance with the Notification concerning qualifications of bond holder representative and authority of bond holder representative.

Clause 44 The approved person shall take the following actions:

(1) Having the bonds to be issued and offered for sale meet the following characteristics:

(a) Being registered bonds and having a statement in the certificate of bonds offered for sale each time that the bond issuer shall not accept transfer registration of bonds in any level if such transfer is inconsistent with the transfer restriction as indicated and registered with the Office;

(b) Having the characteristics in accordance with Clause 17(1), (2) and (3);

(c) Complying with the rules prescribed in Clause 18 and Clause 19 in case of an offer for sale of subordinated bonds or perpetual bonds, as the case may be;

(d) In case of an offer for sale of bonds to institutional investors established under Thai law or high net worth investors under Clause 32(1), having the terms and conditions with at least the particulars as prescribed in Section 42(1) to (9) and complying with the first paragraph of Clause 25;
(2) In case of private placement of bonds under Clause 32(2), (3) or (4), the approved person shall not advertise an offer for sale of newly issued bonds and reserved shares. If the distribution of offer documents is made, the approved person shall distribute such documents only to persons with the characteristics or in the limited number as prescribed in Clause 32(2), (3) or (4) as granted approval;

(3) Offer documents (if any) shall contain a statement indicating the transfer restriction under (1)(a) and in case of an offer for sale of subordinated bonds, such transfer restriction shall be clearly indicated.

Clause 45 In cases where any person shows his intention to the approved person to register transfer of bonds, the approved person shall make verification of such transfer. If such transfer is inconsistent with the transfer restriction registered with the Office, the approved person shall not register such transfer, except for transfer by inheritance.

In cases where the approved person has provided the bond registrar, the approved person shall have the bond registrar comply with the rules prescribed in the first paragraph.

Division 5 Additional After-Approval Conditions for Private Placement of Bills

Clause 46 Prior to an offer for sale of bills, the approved person shall obtain an explicit resolution from the company's board of directors approving the issuance of bills, except for the case where the company is required to issue bills according to the rehabilitation plan under the bankruptcy law which has been approved by the court or any other case granted an exemption by the Office.

Clause 47 The approved person shall provide a statement that “These bills are securities and approved for private placement” on the face of the bills. In case of the issuance of bills under Clause 34(1) or (2), the bill issuer shall provide additional statements saying “Being offered for sale only to institutional investors or high net worth investors” and “Non-negotiable” or “With the purpose of transfer among institutional investors or high net worth investors” or any other statement with similar meaning.

Clause 48 In case of an offer for sale of bills under Clause 34(3), the approved person shall not advertise such offer. If the distribution of offer documents is made, the approved person shall distribute such documents only to persons with the characteristics or in the limited number as prescribed in Clause 34(3) as granted approval.

Notified this 13th day of March 2009.

Remark: The rationale for issuing this Notification is to prescribe rules on approval of an offer for sale of newly issued debt securities by a company established under Thai law or a branch of a foreign commercial bank and, so as to promote development and growth of Thai debt securities market, to relax rules on approval of an offer for sale of debt securities to limited group of investors which will help facilitate fund raising through debt securities issuance of the private sector, as well as to re-define an offer for sale to limited group of investors to include an offer for sale of debt securities to institutional investors or high net worth investors without limitation of offer value to be in accordance with international standards.

Definition of Institutional investors and High net worth investors

Notification of the Securities and Exchange Commission No. KorChor. 5/2552
Re: Determination of Definitions in Notifications relating to Issuance and Offer for Sale of Debt Securities

http://www.google.co.jp/url?sa=t&source=web&cd=1&sqi=2&ved=0CBkQFjAA&url=http%3A%2F%2Fcapital.sec.or.th%2Fwebapp%2Fm%2Fdata%2F4604se.pdf&ei=Ob_-TfDxKIfCvgPYmYAw&usg=AFQjCNEY6hzWoGDgBFYMs-PNWUTtp6pOg

Clause 3 In this Notification and the forms attached with the Notifications under Clause 2:

(2) definitions relating to type of investors:

(a) “institutional investors” means:

1. commercial banks;
2. finance companies;
3. securities companies for management of proprietary portfolios or private funds or investment projects established under laws governing finance business, securities business and credit foncier business;
4. credit foncier companies;
5. insurance companies;
6. government units and state enterprises under laws governing budgetary procedures or any other juristic persons established under specific laws;
7. Bank of Thailand;
8. international financial institutions;
9. Financial Institutions Development Fund;
10. Government Pension Fund;
11. provident funds;
12. mutual funds;
13. foreign investors with the same characteristics as investors under (1) to (12), mutatis mutandis;
b. Public offering (PO) and disclosure requirement

The second type is public offering (PO), which can be further subdivided into two additional categories.

The bonds can be bought and sold by any investors. Since these bonds are offered to a variety of investors, they are more actively traded in the secondary market. This bond category can be registered to trade on the Bond Electronic Exchange, BEX. (Having said that, in reality, most of them are traded OTC.)

Disclosure requirement to the listed bond issuer is set for Public offering of Bonds. Disclosure means the reveal to the public of the relevant information of listed bond issuers. The SET/BEX requires these issuers to inform investors of material information, which may affect bond prices or bondholders’ interests or investment decisions. Examples of disclosure (filing) requirements are financial reports at the end of each accounting period, e.g., quarterly and annual financial statements, annual reports.

The publicly offered bond promoters are required to disclose (file) the information.

2. Secondary Market Trading

There are two secondary bond markets in Thailand: the over-the-counter market under the Thai Bond Market Association (ThaiBMA), formerly the Thai Bond Dealing Centre (Thai BDC), and the Bond Electronic Exchange (BEX).

The ThaiBMA has three types of members:

i. Ordinary members—financial institutions with a debt-trading license (dealer);
ii. Extraordinary members—companies that have inter-dealer broker licenses
iii. Associate members—firms that facilitate trades to an ordinary member with a monthly average trading value in each of the past 12 months of less than THB100 million.

BEX has an electronic bond-trading platform overseen by the Stock Exchange of Thailand (SET). Brokerage firm members trade corporate bonds issued by SET-listed companies on behalf of their clients.

As stated above, bond trading in Thailand can take the form of either over-the-counter (OTC) or exchange traded.

Since bonds are normally traded in a big lot and are infrequent as compare to equities, most bonds circulated in the secondary market are traded through OTC which the buyer and seller negotiate either over telephone or through interdealer broker.

Government bonds are the most actively traded securities, accounting for approximately 80-90 percent of total trade.

a. Dealers

In order to trade debt instruments in Thailand, investors require to trade only with the dealers who are financial institutions licensed by the SEC to trade debt instruments.

In 2010, there are 51 dealers have been awarded dealing licenses but only ten are active dealers all of whom are commercial banks.

b. Investors

Investors in bond market are mainly institutions including banks, mutual funds, provident funds, government pension fund and insurance companies.

c. Trading on the OTC Market

Bond trading in Thailand mostly occurred on an OTC basis.

Although there is electronic trading platform called FIRST system provided by the Stock Exchange of Thailand, the volume through this channel has remained low (Less than 5%).

In the OTC market, transactions between the dealers or the inter dealer trading can be done through either telephone or a broker called Inter-Dealer Broker (IDB) who acts as facilitator to the transaction.

Currently, there are two IDB in Thailand name ICAP and Wallstreet.

For the Dealer-to-Client transactions, investors and dealers are still used to negotiate and trade their bonds via telephone.

Trading in secondary market can be grouped into two types; Those are (1) Dealer-to-Dealer (Inter dealers) and (2) Dealer-to-Client.

All traded are required to be reported to ThaiBMA within 30 minutes after execution.
d. Market monitoring and surveillance in the secondary market

ThaiBMA monitors market movement and each trade transaction to ensure that there is no violation of regulation, wrongful conduct, or unfair trading.

Besides daily and regularly monitoring, the ThaiBMA also report to authorities concerned such as the SEC and the BOT.

3. Approval and Filing of the bonds (Extract and Summary) (To be confirmed)

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<thead>
<tr>
<th>Plain Debt</th>
<th>Thailand</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>1. SEC Approval</strong></td>
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<td>1.1. Public Offering (PO)</td>
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<td>1.2. Non-Resident Investor (NRI)</td>
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<td><strong>2. Filing</strong></td>
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<tr>
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<tr>
<td>2.2. NRI</td>
<td>✓</td>
</tr>
<tr>
<td>2.3. Exempt</td>
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</table>

<table>
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<tr>
<td>2.2. NRI</td>
<td>✓</td>
</tr>
<tr>
<td>2.3. Exempt</td>
<td>✓</td>
</tr>
</tbody>
</table>


5. Background Information:

a. The Stock Exchange of Thailand (SET) Bond Electronic Exchange (BEX)

The Stock Exchange of Thailand (SET) was established in April 1975, under the name “The Bangkok Stock Exchange”, as the primary stock market in Thailand.

In 1999, the Market for Alternative Investment (MAI), a subsidiary of SET, was established as an alternative channel for fund-raising of small and medium enterprises with high-potential to grow or newly-established companies with high market value.

SET has also launched the Bond Electronic Exchange (BEX) in 2003 to support the secondary market for bond trading for individual investors.

Bond Knowledge
b. Bond Electronic Exchange (BEX)

Bond Electronic Exchange (BEX), a department of SET, represents and handles electronic trading platform and transactions for fixed income securities in the capital market with concentration around diversification awareness, education, transparency, clearing and settlement, and subsequently increases liquidity.

The Bond Electronic Exchange (BEX), under the Stock Exchange of Thailand (SET), trades debentures or bonds of SET-listed corporations through an electronic trading platform. BEX started trading government bonds in June 2005.

c. Thailand Securities Depository Co., Ltd. (TSD)

Clearing and settlement of securities traded on SET, MAI and BEX, including bonds trading on OTC market, are done by the Thailand Securities Depository Co., Ltd. (TSD).

Thailand Securities Depository Co., Ltd. (TSD) is the official agency responsible for allocating ISIN code in Thailand using standard ISO 6166. Each code contains 12 digits, first 2 digits are prefix, next 9 digits are basic numbers and the last digit is checking digit. TSD allocates ISIN code for equities, corporate bonds, government bonds, warrants and all other securities deposited with TSD.

Bonds and debentures are issued and registered in the holder’s name. Fixed Income is traded mainly on the Over-The-Counter (OTC) market. The majority of bonds trading are occurred over-the-counter (OTC).

Both government bonds and corporate debentures publicly sold are dematerialized and settled through TSD’s system, gross settlement processing, which is linked to the BOT’s payment system called “BAHTNET II”.

d. Thai Bond Market Association (ThaiBMA)

In September 2005, the Thai Bond Dealing Centre became the Thai Bond Market Association (ThaiBMA).

ThaiBMA is a self-regulating organization that functions as an information center, code and standard setter, forum for bond market updates, and a frontline for market surveillance. It has also sold its newly developed electronic trading platform to SET.

The Thai Bond Market Association (ThaiBMA) is a securities business related association under the Securities and Exchange Commission Act B.E. 2535. Its main purposes are to be a self-regulatory organization (SRO) for a fair and efficient operation of the bond market and to be an information center for the Thai bond market.

It also plays functional roles on market development, market convention and standards and being Bond Pricing agency for the industry.
In addition, ThaiBMA provides a forum through which industry professionals can respond to current issues and play a role in shaping the future of the Thai bond market.

As “Bond Pricing Agency,” ThaiBDC also provides model yield and pricing data for mark-to-market purpose of investors such as mutual funds. This is deemed very useful in the case of illiquid debts securities.

H. Professional (wholesale) Market / Retail Market

Wholesale would be Institutional or Juristic Investors, while retail would be equivalent to Individual Investors.

According to the SEC regulations, wholesale investors are categorized as 13 types of institutional investors which comprise of Commercial bank, Finance companies, Securities companies, Bank of Thailand, International financial institutions, financial institution development fund, Government pension fund, Mutual fund and foreign investors that have the above characteristics.

Following is a list of the qualified institutional investors under the law governing the issuance of debentures:

1. Commercial banks
2. Finance companies
3. Securities companies for management of proprietary portfolios or private funds or investment projects established under the laws governing the finance business, securities business and credit foncier business
4. Credit foncier companies
5. Insurance companies
6. Government units and state enterprises under the laws governing the budgetary procedures or any other juristic persons established under specific laws
7. Bank of Thailand
8. International financial institutions
9. Financial Institutions Development Fund
10. Government Pension Fund
11. Provident funds
12. Mutual funds
13. Foreign investors with the same characteristics as investors under (1) to (12), mutatis mutandis

The concept of QFII does not only apply to securities available for sale in the Exchange Market but also applies to debentures issued by way of private placement.

I. Definition of Professionals / Professional Investors

There is no defined concept of professionals; it can be assumed that wholesale investors represent the professionals.

Under Thailand jurisdiction they do not have the concept wholesale and retail or concept of professional.

Thailand have the concept similar to wholesale and retail but only in the case where a company wishes to issue shares to its employees through an employee stock option plan (ESOP). However, this is considered equity and not a debenture. The purpose of
ESOP is to have an employee become a shareholder of the issuing company (employer).

There is a concept of the Institutional Investors and High Net worth Investors in Thailand. These concepts are related to the rule of exemption of the full disclosure based regulations.

Definition of Institutional investors and High net worth investors

The Notification of the Securities and Exchange Commission No.KorChor.5/2552 Re: Determination of Definitions in Notifications relating to Issuance and Offer for Sale of Debt Securities

http://www.google.co.jp/url?sa=t&source=web&cd=1&sqi=2&ved=0CBkQFjAA&url=http%3A%2F%2Fcapital.sec.or.th%2Fwebapp%2Fdata%2F4604se.pdf&ei=Ob_TfDxKlfCvgPYmJyYAw&usg=AFQjCNEY6hzWoGDDgBFVMs-PNWUiTp6pOg

J. Credit Rating System (CRS)

According to the SEC regulations, newly issued debentures to public (PO) issues must have credit rating from an authorized credit rating agency.

Most private placement issues are also required credit ratings but with more relaxing regulation. (See 2.C.3)

Presently, there are 2 credit rating agencies authorized by the SEC in Thailand, namely, TRIS Rating Co., Limited and Fitch Ratings (Thailand) Limited.

List of Trustee who has been given an approval by the Office of the SEC

http://www.sec.or.th/securities_issuance/Content_0000000226.jsp?categoryID=CAT0000200&lang=en

Currently, there are three major government and public agencies that have pivotal role in formulating policies and regulating the Thai bond markets:

The Ministry of Finance (MOF), the Bank of Thailand (BOT) and the Securities & Exchange Commission (SEC).

<table>
<thead>
<tr>
<th>Are credit rating agencies regulated?</th>
<th>YES</th>
<th>NO</th>
</tr>
</thead>
<tbody>
<tr>
<td>Is it mandatory to have credit rating for issuance of corporate bonds?</td>
<td>X</td>
<td></td>
</tr>
<tr>
<td>Are ratings provided by international agencies permitted?</td>
<td>X</td>
<td></td>
</tr>
<tr>
<td>Is it possible to get more than one rating for a corporate bond issue?</td>
<td>X</td>
<td></td>
</tr>
<tr>
<td>If it is possible to get more than one rating for a corporate bond issue, is it mandatory to disclose all ratings for that issue?</td>
<td>X</td>
<td></td>
</tr>
<tr>
<td>Is it mandatory for CRAs to update all corporate bond issues?</td>
<td>X</td>
<td></td>
</tr>
<tr>
<td>If yes then what is the time interval after which the ratings need to be updated?</td>
<td>(Required for IPO)</td>
<td></td>
</tr>
<tr>
<td>Are unsolicited ratings permitted?</td>
<td>X</td>
<td></td>
</tr>
</tbody>
</table>

When the company issues bond, it is compulsory to have rating for such issuance of the bond.

Normally, the rating agencies will update company rating once a year.

If there is any circumstance which may impact the company performance or its financial status, the CRA has responsibility to monitor and update the rating of such company.

K. Bond Related Systems for Investor Protections (Trustee System, etc.)
1. Retail Investors

There are no specific rules governing retail investors in the Thai bond market. The Thai Bond Market Association (ThaiBMA) provides a special website for retail investors, Thaibond.com. Most financial institutions in Thailand provide services for retail investors interested in buying and selling bonds.

2. Foreign investors

There are no restrictions on foreign investors investing in Thai securities. Direct and portfolio investments are freely permitted. Capital can be freely transferred into the country and deposited in a foreign currency account with an authorized bank within 7 days. Investment funds, dividends, profits, and interest payments after settlement of taxes can be repatriated freely. Securities, promissory notes, and bills of exchange may be sent abroad without restriction.

Section IV of the Bank of Thailand (BOT) discusses exchange regulations for foreign investments. 
http://www.bot.or.th/English/ForeignExchangeRegulations/FXRegulation/Pages/ExchangeControlLaw.aspx

Section IV. FOREIGN INVESTMENTS:

Transfers in foreign currency for direct and portfolio investments in Thailand are freely permitted. Proceeds must be surrendered to an authorized bank or deposited in a foreign currency account with an authorized bank in Thailand within 360 days.

Repatriation of investment funds and repayment of overseas loans can be remitted freely upon submission of supporting documents to an authorized bank. For repatriation of investment funds, evidence of sale or transfer of such investment shall be submitted. For loan repayment, evidence of inward remittance of such loan and loan agreement shall be submitted.

3. Bondholder Rights

The Civil and Commercial Code and the Bankruptcy Act cover basic bondholder rights. 
http://www.samuiforsale.com/Law-Texts/thailand-civil-code-part-1.html
http://asialaw.tripod.com/articles/bankcourt.htm

The Civil and Commercial Code covers the principles and rules for civil law for business and individuals.

Obligations, contracts, mortgage, and other forms of loan security fall under the Civil and Commercial Code, as well as liquidation procedures for insolvent debtors.

Under the Bankruptcy Act, creditors, including the bondholders, can file a petition with the Bankruptcy Court for a rehabilitation or bankruptcy proceeding against a debtor's business.

Indenture agreements in bond issues can also specify a trustee or bondholder
representative. This trustee oversees bondholder rights, including the filing of claims and demand payments from the issuer or guarantors.

Bondholders can sue and claim for damages from the trustee in case the trustee acts in bad faith or causes damages to bondholders.

Foreign bondholders have rights similar to Thai bondholders.

Bond documents (e.g., prospectus, term sheets, or indenture agreements) may also contain covenants and relevant default clauses specific to the bond issue to provide additional protection for bondholders.

The Thai Bond Market Association (ThaiBMA) provides copies of corporate bond prospectuses.


4. Prevention of Fraud

The Enforcement Department of the Securities and Exchange Commission (SEC) investigates and gathers evidence on possible offenses under the Securities and Exchange Act, the Provident Fund Act, and the Royal Enactment on Special Purpose Juristic Persons for Securitization.

Typical violations under SEC purview include insider trading, share-price manipulation, false or misleading information regarding securities, operating securities businesses without proper licenses, mismanagement, and fraud.

5. Ethics

The Stock Exchange of Thailand (SET) serves as a center for trading listed securities. It is a self-regulatory organization that governs member companies’ conduct in dealing securities.

SET is also responsible for marketplace surveillance, and supervising and enforcing disclosure standards for listed companies.

It provides essential systems for securities trading, such as a clearing house, securities depository center, and securities registrar.

The Thailand Futures Exchange (TFEX), a subsidiary of SET, is a derivatives exchange that offers products for effective hedging. It is governed by the Derivatives Act of 2003 under the supervision of SEC.

The TFEX trading infrastructure is designed to ensure a fair, orderly, and transparent market by offering market participants a high-quality, cost-efficient, and comprehensive range of services—including an order entry facility, a matching system, and market dissemination through an electronic trading platform.

SET also operates the Bond Electronic Exchange (BEX). The relevant trading rules and Guidelines on membership, registration, and other requirements are available at the SET website.
The Thailand Bond Market Association (ThaiBMA) operates the secondary bond market, registers dealers, and monitors all market activity. It is self-regulatory, and operates standards and conventions for bond trading. The ThaiBMA website provides guidelines on membership, registration and trading of debt instruments, registration of traders, ethics and good practices of dealers, and reporting requirements.

http://www.thaibma.or.th/main.html
http://www.thaibma.or.th/sro/section6.pdf
http://www.thaibma.or.th/sro/section7.pdf


The SEC Act B.E. 2551 (2008) has come into force on March 5, 2008. The SEC Act provides strong protection for investor’s interest and enhances corporate governance of listed companies. This is a robust foundation for quality products and confidence in the Thai capital market.

The SEC Act comprises of three major areas of (1) Regulatory bodies (2) Corporate Good Governance and (3) Investor Protections with the objectives to raise the standard of the Thai Capital Market to the international level.

Investor Protections includes:

a. Propose agenda items for shareholders’ meetings
b. Sue for damages from disclosure of falsified information
c. Claim to disgorge ill-gotten benefits obtained by company directors or management in bad faith
d. Receive reasonable litigation expenses from the company as ordered by the court
e. Directors and management of companies shall be provided with a clearer scope of duties and liabilities


The Trust for Transactions in Capital market Act (Trust Act) was in effective on April 16, 2008. The objectives of this new Trust Act are to strengthen and introduce the new investment alternatives to the Thai capital market.

The Summary of Trust Act is listed below;

a. Characteristic of Trust: A trust is a legal binding of three parties as follows;
   i. Settlor:
      A Settlor under this Act is limited only to a juristic person who is an issuer of securities under the SEC Act B.E. 2551 (2008) or an originator in a securitization transaction, or as specified by the Securities and Exchange Committee (SEC).
   ii. Trustee:
       Licenses authorized by the SEC is required. Trustees can be commercial banks or financial institutions, banks established under the specific laws, or other juristic persons as specified by the SEC.
iii. Beneficiary:
There is no restriction imposed on the type of person who can be a beneficiary. Also, the settlor and trustee can be a beneficiary. The Trust Act provides that the interest of such settlor / beneficiary and trustee / beneficiary in the trust fund must not exceed the limit specified by the SEC; otherwise, the excess portion will be shared among the other beneficiaries to that trust.

b. There are two types of trusts under the new Trust Act

i. Passive Trust
   A) Employee Stock Option Plan (ESOP)
   B) Derivative Warrant
   C) Bonds Issuance
   D) Securitization

ii. Active Trust
   A) Institutional Investor & High Net Worth Trust Fund
   B) Real Estate Investment Trust (REIT)
   C) Special Purpose Trust (SPT)
   D) Employee Joint Investment Program
   E) Islamic Bond (SUKUK)

c. Creation of Trusts

Under the Trust Act, a trust is required to create through a contract between a settlor and a trustee where the settlor will be the one who expresses an intention to create a trust as well as transferring property to the trustee and submitting a letter showing its own intention to create a trust to the SEC office.

If the settlor and the trustee are the same person, a transfer of assets is not required.

The Trust Act requires that a trust may be created only for transactions which will benefit the capital markets, for instance, in the issuance of securities or securitization transactions.

Therefore, trusts used exclusively in banking transaction and not related to capital market transactions cannot be created.

d. Fiduciary relationship focuses on three key rules:

i. Bankruptcy Remoteness – trust property legally owned by a trustee shall not be enforced for payment to creditors of trustee even though the trustee becomes bankrupt.

ii. Fiduciary Duties – a trustee shall manage trust with skills, loyalty and
reasonable care for the best interest of beneficiary, and shall not put itself in a position where there may be conflict of interests unless it is remuneration or a fair transaction being sufficiently disclosed to the beneficiary in advance and no objection from the beneficiary.

iii. Beneficiary Protection – tracing and recovery are tools for protecting the beneficiary’s interest. In case of tracing, a beneficiary has the power to trace trust property from a third party who receives such property with bad faith or knowing or having reasonable grounds to know that it is a breach of trust or without consideration. For recovery, the beneficiary has the right to claim compensation for benefit of trust from a trustee who fails to manage trust property in accordance with the trust contract or the Act itself.

e. Persons who are eligible to apply

The persons who are eligible to apply for an approval to undertake trust business are;

i. A commercial bank under the Financial Institutions Business Act;
ii. A financial institution established under specific law;
iii. A security company with eligible Broker / Dealer / Underwriter / Mutual fund and private license.

f. Bond representative or debenture holder representative

Bond representative or debenture holder representative can play a Trustee’s role in Thailand.

Trust law exists but no significant bearing for bond issuance.

Public bond issuance requires ‘bond representative’ (BR); must register with SEC.

BR sets up contract and Terms & Conditions for bond issue, follows SEC guidelines.

BR has fiduciary duty, plus any duty and liability set out in the T&C; both appointment of BR and actual T&C need to be registered with SEC.

Debenture representatives will be responsible for implementing the debenture holder’s resolutions.

Under Thai law, debenture representative responsibilities are very similar to the activities of a trustee. Responsibilities and obligations of a debenture representative have been stipulated in the law and are more specific in the terms and conditions of the debenture.

Bond holders representatives (bond trustee) have the duty to look after the interest of the bond holders. They will act for the benefit of the bond holders and follow up whether the issuers comply with the covenants.


The Deposit Insurance Agency (DIA) was launched on August 11, 2008 under the Deposit Insurance Act.
Deposit insurance Agency is established to protect depositors within a certain coverage amount against the loss of their deposits placed in a financial institution.

The source of fund for compensation mainly comes from premiums collected from financial institutions which are members of deposit insurance system.

Non-Resident accounts are not protected under this Act.

Key Features of the Deposit Insurance Act

a. Membership of Deposit Insurance Agency is compulsory for commercial banks, foreign bank branches, finance companies and credit finance companies. The members will pay premiums to the Agency at the rate of 0.4% annually on deposits. This premium rates are expected to vary in the future.

b. The maximum coverage is THB 1 million per depositor per institution. The amount of deposit exceeds this coverage is to be recovered from assets of the failed institution through the process of liquidation. The authority will gradually reduce coverage from full guarantee to the target amount at THB 1 million within 4 years. The first year of the establishment of the Agency or year 2008, the full coverage was remained, and the coverage will be reduced to THB 100 million, THB 50 million, THB 10 million and finally THB 1 million of the fifth year of establishment or in year 2012.

c. The Deposit Insurance Agency will act as a liquidator of a failed financial institution, reimburse for the compensation made and also make payment to other creditors according to their shares.

L. Governing laws of bond issuance

Governing Laws of Bond issuance, Self-Governing Rules, Related Legal and Regulatory issues behind the Market:

- SEC Act B.E.2535 and its regulations
  http://www.sec.or.th/laws_notification/Content_0000000189.jsp?categoryID=CAT0000015&lang=en

- BOT Act B.E.2485
  http://www.bot.or.th/English/FinancialInstitutionsDevelopmentFund/Law_Notification/DocLib_Acts/Act_BOTb.e.2485.pdf

- Ministry of Finance – Public Debt Management Office

As stated above, SEC Act and SEC notifications govern the issuance of corporate bonds.

Government bonds and state enterprise bonds are issued under the Public debt management Act.

BOT bonds are issued under the Bank of Thailand Regulation.

M. Transfers of interests in bonds
1. General rule

The transfer of debentures will be valid upon delivery of such debentures with the endorsement of transfer by a person having his name as the owner or by the last transferee.

The transfer will legally bind a third party once the transfer has been registered with the debenture issuer in the debenture registered book.

For government securities, transfer is done on a DVP basis.

2. Actual Registration and Transfer process:

The Thailand Securities Depository Company Limited (TSD) is the depository for equities, corporate bonds, and government bonds.

Securities held with the TSD are registered in the name of “Thailand Securities Depository Company Limited for Depositors.”

Securities transferred within the TSD do not require re-registration.

Scripless securities from a settled purchase can be redelivered on SD.

Physical certificates can be converted to scripless form at the depository within the same day.

Re-registration of physical certificates following a purchase takes approximately 30 to 45 business days, during which time, the security cannot be sold. Although corporate bond dealers instruct the TSD to transfer bonds to the counterparty upon receipt of the cash payment by check, registration of corporate bonds is done separately with the registrar appointed by the issuing company.

The TSD is the registrar for most listed corporate bonds.

Removal of the securities from the TSD in physical form can take 30 to 45 business days and the TSD assesses a service charge for the withdrawal of physical shares.

Unlisted securities and shares can be registered in the investor’s own name, or in the name of the global custodian, in care of the sub-custodian.

Local nominee registration is prohibited.

The sub-custodian sends non-TSD eligible shares for registration upon receipt, unless there are specific instructions to hold the securities and shares in street name.

Investors can hold securities and shares in street name, but they will not receive entitlements from corporate events.

Registration generally takes 30 to 45 business days, during which time shares cannot be delivered and should not be sold.

Physical securities and shares from a settled purchase can be delivered onwards once all required documents are in place.
The BOT acts as the registrar for government securities, which are registered in beneficial owner name, or in the global custodian’s name, under the Bond Registry System.

Under the Bond Registry System, the buyer and seller must endorse the back of the certificates and submit the original written instructions to the BOT.

The Title to the securities passes on T+2 after the proceeds are credited to the seller’s cash account.

The BOT acts as the registrar for all government bonds, Treasury bills, State-Owned Enterprise Guaranteed Bonds, and Financial Institution Development Bonds.

3. Custodian Bank point of View

Custodian banks do recognize only the registered owner (their client), they do not know/recognize the end beneficiary owner.

On the ‘Book Closed Date’, they will submit their client name/registered owner who has holding over those securities as of ‘End of day of Record Date’ to the Securities Registrar to ensure that their clients are well receipt of the (mandatory) Corporate Action entitlement, i.e. coupon payment. For Voluntary Corporate Action event, they shall wait for client’s instruction if client wish to participate in the particular corporate action event.

4. Beneficial Ownership Disclosure

Beneficial ownership at the account registration level is disclosed to the TSD on book closure date for determining entitlement on corporate events. This disclosure is regulated via the SET’s procedural regulations.

The local agent discloses the information in accordance with the critical dates.

The TSD assesses penalties for delays in reporting or for corrections of inaccurate information.

The TSD reconciles beneficial ownership disclosures against share balances on their records in order to ensure all disclosures have been made. The TSD is also authorized to inspect the list of beneficial owners at any time; however, in practice, this is not common.

N. Definition of securities

1. Definition on the Securities and Exchange Act

Securities and Exchange Act B.E. 2535 Section 4. Stipulate the definition of securities as follows.

http://www.sec.or.th/laws_notification/Content_0000000189.jsp?categoryId=CAT0000015&lang=en

In this Act "securities" means,

(1) treasury bills;
(2) bonds;
(3) bills;
(4) shares;
(5) debentures;
(6) investment units which are instruments of evidence representing the rights to the property of a mutual fund;
(7) certificates representing the rights to purchase shares;
(8) certificates representing the rights to purchase debentures;
(9) certificates representing the rights to purchase investment units;
(10) any other instruments as specified by the SEC.

"bill" means any bill issued for raising funds from the public as specified in the notification of the SEC.

"debenture" means any debt instrument or whatever name excluding bills, divided into units, each with equal value and a predetermined rate of return, issued by any company to a lender of purchaser, representing the right of the holder of such instrument to receive money or other benefit.

2. Debentures on the PUBLIC LIMITED COMPANIES ACT, B.E. 2535 (1992)

CHAPTER XI Debentures:

Section 145. The borrowing by the company by means of the issuance of debentures for offer for sale to the public shall be in accordance with the law on securities and stock exchange, and section 25 shall apply mutatis mutandis.

The resolution approving the issuance of debentures under paragraph one shall require the resolution of the meeting of shareholders passed by a vote of not less than three-fourths of the total number of votes of the shareholders attending the meeting and having the right to vote.

CHAPTER III Offer of Shares for Sale to the Public

Section 24. The offer of shares for sale to the public or to any person shall be in accordance with the law on securities and stock exchange.

Section 25. The promoters or the company shall submit to the Registrar a copy of the documents relating to the offer of shares for sale to the public which shall be prepared and submitted to authorities under the law on securities and stock exchange, within fifteen days as from the date of submission to such authorities in accordance with the rules, procedures and conditions prescribed by the Registrar.

O. Self-governing rules behind the market

1. ThaiBMA

The Thai Bond Market Association (ThaiBMA) is a self-regulated organization, licensed to run an efficient market and act as an information center for Thailand's secondary bond market. It is responsible for developing the market, establishing market conventions and standards, and acting as a bond pricing agency. It also provides a forum for market professionals to move toward a more mature and sophisticated Thai bond market.

a. ThaiBMA members
Membership of ThaiBMA can be classified into 3 types; each of which is subject to different membership fee and requirement;

i. Ordinary member is a financial institution that has the debt trading license (dealer).
ii. Extraordinary member is a company that has inter-dealer broker license (IDB).
iii. Associate member is provided for a dealer that has monthly average trading value in the past one year less than 100 million baht per month.

In June 2007, membership of ThaiBMA consists of 52 commercial banks and securities companies.

b. Roles and functions of Thai BMA as SRO

ThaiBMA oversees and monitors the conduct of its members in order to ensure fairness and efficiency in debt securities trading. It is committed to retaining the confidence of its membership, regulators and investors. Parts of SRO functions include the following:

i. Perform market monitoring and surveillance to ensure that all trading activities complied with relevant laws and regulation and act as the front line to detect any unfair trading practices.
ii. Established Ethics and Code of Conduct for members and traders.
iii. Issuing rules and guidelines regarding debt securities trading and good market practice.
iv. Responsible for bond trader examination and registration and provide them with ongoing education to enhance their professionalism.
v. Determine enforcement procedure to penalize those who did not comply with the regulation.

There is a Memorandum of Understanding (MOU) between the SEC and ThaiBMA regarding Bond Market Supervisory Cooperation.

To enhance the bond market best practices and to ensure, the registered traders should have adequate knowledge in relevant rules, regulations and ethic as well as knowledge in the bond market. Effective from November 16, 2005. The SEC Regulation required that all securities companies appoint a trader that register with the ThaiBMA in bond trading.

2. Exchanges are not regarded as SRO in Thailand.

P. Bankruptcy procedures

According to the Bankruptcy Act B.E. 2483, corporate bond holders shall be treated as ordinate creditors.

In addition, under the Securities and Exchange Act B.E. 2535 and Trust for Transactions in Capital Market Act B.E. 2550, if the issuer of corporate bond set up a reserved account or sinking fund in a form of trust, the bondholders shall have bankruptcy remoteness and the ultimately rights in that trust property.

When the company goes bankrupt, corporate bond holders shall have the right as to the property of the company to receive performance of an obligation due to them as the following ranks.
1. Bondholders for which the issuer has set up reserve account or sinking fund in a form of trust
2. Secured creditors
3. Unsecured creditors

Q. Meetings of bondholders

In case of public offered bonds, bond representative (trustee) will be responsible for implementing the bondholder’s resolutions.

Under Thai law, bond representative responsibilities are very similar to the activities of a trustee.

Responsibilities and obligations of a bond representative have been stipulated in the law and are more specific in the terms and conditions of the debenture.

R. Event of default

Generally, an event of default will be stipulated in the terms and conditions of the debenture.

Under Thai law, the terms and conditions are deemed to be an agreement between the debenture issuer and the debenture holder.

The following are examples of “events of default” that are normally stipulated in the terms and conditions of a debenture:

1. Non-payment: If the Issuer makes a default in the payment of any principal, premium or interest due in respect of the Bonds.

2. Breach of Other Obligation: If the Issuer does not perform or comply with one or more of its other obligations under the Bonds, the Trust Deed or Terms and Conditions.

3. Insolvency: If the Issuer or any of its group entities becomes insolvent or bankrupt or is unable to pay its debts, stops, suspends or threatens to stop or suspend payment of all or a material part of its debts, by Court order.

4. Enforcement Proceeding: If a distress, attachment, execution, seizure before judgment or other legal process is levied, enforced or sued out on or against any material part of the property, assets or turnover of the Issuer or any of its group entities and is not discharged or stayed within 60 days.

5. Winding-up: If an order is made or an effective resolution passed for the winding-up or dissolution or administration of the Issuer or any of its group entities.

6. Security Enforced: If an encumbrancer takes possession or an administrative or other receiver or an administrator or other similar officer is appointed of the whole or any substantial part
of the property, assets or turnover of the Issuer or any of its group entities and is not discharged within 60 days.

The debenture holder and/or debenture holder representative (Trustee) will normally recognize and declare the default.

The declaration of event of default will be made in accordance with the terms and conditions of the debentures.

Thai law is silent as to whether the default will happen during the day or at the end of the day. However, in practice, the default will immediately occur when the debenture holder / or debenture holder representative (Trustee) declares an event of default.

The precedent of a default of debentures normally occurs on the grounds that the debenture issuer fails to pay interest and to repay the principal to the debenture holder when due.

S. Major Players in the Market

Thailand's fixed-income market participants include issuers from the government and corporate sectors.

Major bond investors include pension funds or provident funds, asset management companies, mutual funds, commercial banks, government savings banks, insurance companies, savings funds, and corporate and retail investors.

A number of authorized securities companies and a few market associations also participate in the market. The TRIS Rating Co., Ltd. (TRIS Rating) covers financial institutions, private companies, and state enterprises.

T. Degree of Opening of Domestic Bond Markets to Foreign Investors/ Issuers

In 2004, the Ministry of Finance announced permission for foreign institutions to issue Bath-denominated bonds for trading in Thailand, with restrictions on certain institutions as below;

1. International financial institutions incorporated under treaties, regardless whether or not Thailand is a member of those treaties.

2. Foreign governments or foreign government institutions incorporated under specific laws.

3. Juristic persons incorporated under foreign laws who are not entitled to the common permission but must apply for it on a case by case basis and are prohibited from remitting Thai Baht out of the country.

Overseas remittance is possible only after foreign exchange.

The issuance of bonds in this connection must come under commitments with and permission of the MOF. Issuers must complete the offering of bond within six months after permission granted by the MOF.

Limited companies and public companies incorporated under foreign laws are allowed to
issue bonds under the assumption of permission of the SEC.

See the information in the attached file (?) named “CMD Scorecard Thailand”
II. Primary and secondary market regulatory frameworks

A. Rules and Regulations - Thai market Regulatory Structure

Thailand's capital market is governed by the rules and regulations issued and enforced by the Bank of Thailand (BOT), Ministry of Finance (MOF), Securities and Exchange Commission (SEC), Thai Bond Market Association (ThaiBMA) and the Stock Exchange of Thailand (SET).

Market Regulators:

1. Ministry of Finance (MOF)
   http://www2.mof.go.th/government_agencies.htm

   The MOF is the pre-eminent regulator and oversees the entire financial and capital market of Thailand. The activities of the Bank of Thailand (BOT) and the Securities and Exchange Commission (SEC) are overseen by MOF.

   The roles and responsibilities of the MOF are as follows:

   a. The MOF is the top administrator who sets the overall Fiscal and Monetary Policy directions of the government
   b. It oversees matters concerning Fiscal Policy, Customs, Excise, Revenue, Public Debt and State Enterprise Policy
   c. It is also vested with the power to provide loan guarantees for the Government agencies, financial institutions and state enterprises

2. Bank of Thailand (BOT)
   http://www.bot.or.th/English/AboutBOT/index/Pages/RolesAndResponsibilities.aspx
   http://www.bot.or.th/English/LawsAndRegulations/DocLib_EngLaw/Law_E01_Bot.pdf

   The Bank of Thailand (BOT) supervises all financial institutions in Thailand. The Bank of Thailand was first set up as the Thai National Banking Bureau. The Bank of Thailand Act was first promulgated on April 28, 1942 vesting the Bank of Thailand with the responsibility for all central banking functions. The Bank of Thailand commenced operations on December 10, 1942.

   The Bank of Thailand Act, B.E 2485 (1942) was amended by B.E. 2551 (2008) in order to put emphasis on BOT's social responsibility, to create a mechanism to guard against economic crisis, as well as to set up BOT’s decision making process to ensure good governance and transparency in the organization.

   Meanwhile, members of the public will be able to audit and increase the understanding of the BOT's operations.


   The BOT's major roles and responsibilities are:

   a. Print and issue banknotes and other security documents
   b. Promote monetary stability and formulate monetary policies
   c. Monitor the foreign currency reserve
d. Provide banking facilities to the government
e. Provide banking facilities for the financial institutions
f. Supervise and examine the financial institutions
g. Establish or Support the establishment of payment system
h. Manage the country’s foreign exchange rate under the foreign exchange system and manage assets in the currency reserve according to the Currency Act
i. Control the foreign exchange according to the exchange control act
j. Manage the BOT’s assets


The SEC Act B.E. 2535 (1992) was amended by SEC Act B.E. 2551 (2008) which was in effective on March 5, 2008.

The SEC objectives are to supervise and develop the Capital Market both primary and secondary markets as well as financial and securities related participants and institutions.

Its primary roles are to formulate policies, rules and regulations regarding the supervision, promotion, and development of securities businesses as well as other activities pertaining to the securities business.

The Policy objectives of the SEC in supervising and developing the capital market are to:

a. Maintain fairness in capital market and financial market
b. Develop and enhance efficiency of the capital market and financial market
c. Maintain long-term stability of the financial system and
d. Strengthen international competitiveness of the Thai capital market

The SEC’s responsibilities in supervising the Thai capital market can be summarised into 6 major areas:

a. Securities Issuance and Business Takeover
b. Securities Businesses
c. Derivative Business
d. Investment Management Businesses
e. The Exchanges
f. Unfair securities trading practice

Securities Issuance:

The SEC Act allows the business sector to issue and offer various kinds of securities, namely equity, debt instruments and hybrid instruments for sale to mobilise funds from the public.

The issuance and offer must be beneficial to the country's economic and social prosperity.
Under the SEC Act, eligible equity or hybrid instrument issuance is restricted to public limited companies only (including the incorporators of public limited company who can issue and offer equities), while issuance of debt instruments can be undertaken by both public limited companies and limited companies.

Business Takeover:

With respect to takeover and change of control, the takeover sections of the SEC Act provide shareholders with adequate information and fair treatment.

- **Information Disclosure**
  
  A person acquiring or disposing of shares, share warrants, Non-Voting Depository Receipts (NVDR) and convertible securities, which can be converted into shares of companies having their securities listed on the SET or MAI, or of a public limited company, must file an acquisition or disposition report (form 246-2) to the SEC within three business days when such acquisition or disposition causes the aggregate holding of the same type of security to reach or pass a multiple of 5% of the total number of voting rights of the business.

- **Tender Offer**

  A person who acquires or holds securities of a business up to the point at which the change in control of a business takes place must issue a tender offer to provide all securities holders with an equal opportunity to sell their securities to the offerer.

  The securities holders must also receive adequate information and advice to assist them in making such decision. Directors are required to make recommendations with respect to the proposal.

  The trigger points which are regarded as changes in the control of a business and which require the making of a tender offer to purchase all securities, are defined at 25%, 50% and 75% of the total number of voting rights of the business.

  The offer price for the tender offer must be the same for all shareholders or securities holders and must not be less than the highest price at which the acquirer had acquired such securities within 90 days prior to the tender offer.

  Apart from the mentioned mandatory offer, a person may also make a voluntary offer in order to purchase and hold 25% or more of the securities of a business under the provision of the Takeover sections of the SEC Act.

Securities Businesses:

Under the SEC Act, “Securities Businesses” means securities brokerage; securities dealing; securities underwriting; investment advisory services; mutual fund management; private fund management; securities borrowing and lending, securities financing, inter-dealer brokerage, venture capital fund management and other business relating to securities as specified by the Minister of Finance upon the recommendation of the SEC.

The SEC Act requires all operators of securities businesses to be licensed by the
Minister of Finance. Applications and screening are done at the SEC.

The requirements include initial capital adequacy, a fit-and-proper capability for management, directors and controlling shareholders, and an assessment of internal control and risk management and supervisory systems.

In addition, the SEC supervises securities businesses according to their risks, whether they comprise financial risk, operation risk, internal control risk, customer relation risk, information technology risk and other areas.

Each company must have sufficient capital to withstand business risk, whereby different weights are assigned to each business area, with the main objective of maintaining the stability and creditability of the whole system rather than the survival of an individual securities company.

SEC also pays particular attention to client treatment and the structure of the securities businesses in fostering efficiency in securities trading and maintaining competition at an appropriate level.

Investment Management Businesses:

Investment management businesses offer an important alternative investment vehicle for investors, with the advantage of risk diversification, and the employment of professionals who are experts in investment.

Type of investment management businesses includes mutual fund management, private fund or discretionary fund, pension fund and provident fund management (for both retail investors and institutional ones).

The investment management businesses are entrusted to take care of the assets of public investment, and the SEC conducts stringent supervision on them to make sure that they are knowledgeable and capable of performing their fiduciary duties in managing clients’ assets with honesty, integrity and for the utmost benefit of investors.

4. The Exchanges

Under the SEC Act, the establishment of any organised securities trading center requires a license from the SEC. Presently, there are 4 Securities Exchanges in the Thai Capital Market comprising of 2 stock exchanges (SET and MAI), 1 bond exchange (BEX), and 1 derivative exchange (TFEX).

a. The Stock Exchange of Thailand (SET):

The Stock Exchange of Thailand (SET) was established in 1975 under the Securities Exchange of Thailand Act B.E. 2517 (1974) and members are securities companies. Securities trading in the SET are in scripless form and are settled between brokers and custodian accounts. Physical securities must be converted into scripless form prior to trading in SET.

b. The Market for Alternative Investment (MAI):

The Market for Alternative Investment (MAI), subsidiary of SET, was officially commenced operation on June 21, 1999. MAI’s main objective is to create new fund
raising opportunities for Small and Medium-sized Enterprises (SMEs) as well as to provide a greater range of investment alternatives for investors.

c. The Bond Electronic Exchange (BEX)

The Bond Electronic Exchange (BEX), also subsidiary of SET, was launched on November 26, 2003; BEX’s main role is to support the secondary market for bond trading. As majority of bond trading are in OTC market, therefore, BEX’s objective is to expand bond activities to individual investors.

d. The Thailand Futures Exchange Public Company Limited (TFEX):

The Thailand Futures Exchange Public Company Limited (TFEX), subsidiary of SET, was established on May 17, 2004 as an exchange for trading of derivatives products. TFEX’s trading method centers around electronic trading. All orders and quotes are entered into a central order book where they are automatically sorted by type, price and entry time. The settlement in TFEX is through electronic trading and clearing platform using NASDAQ OMX technology.

B. Securities Issuance Rules in Brief

http://capital.sec.or.th/webapp/nrs/nrs_print_en.php?printfrom=R&ref_id=72

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<td>Approval/Disclosure/After Sell Duties for ESOP of Foreign Companies</td>
</tr>
<tr>
<td>Filing of the registration statement and the draft prospectus</td>
</tr>
<tr>
<td>- lodgment Registration Statement for debenture issuance pursuant</td>
</tr>
<tr>
<td>(For the issuers who ask for approval to offer debt securities subject to current notification)</td>
</tr>
<tr>
<td>(For the issuers being granted approval to offer debt securities subject to Kor.Yor 31/2549 notification)</td>
</tr>
<tr>
<td>- Registration Statement for SUKUK</td>
</tr>
<tr>
<td>- Filing the registration statement</td>
</tr>
<tr>
<td>- Filing the draft prospectus and distribution of the information before selling of securities</td>
</tr>
<tr>
<td>- Governance of publicly traded company pursuant to chapter 3/1</td>
</tr>
<tr>
<td>- Company exempt from chapter 3/1</td>
</tr>
<tr>
<td>- Related parties transaction</td>
</tr>
<tr>
<td>- Acquisition or dispose of asset</td>
</tr>
<tr>
<td>- Report on the interest of director, executive and related person</td>
</tr>
<tr>
<td>- COMPANY SECRETARY/DOCUMENT STORAGE</td>
</tr>
</tbody>
</table>
1. Approval for Securities Offering

See the SEC Act & regulations related to bond issuance in the web link below.
http://www.sec.or.th/securities_issuance/Content_0000000007.jsp?categoryID=CAT000066&lang=en

The SEC Act B.E. 2535
Chapter 2 Issuance of Securities
Division 1 Approval for the Offering of Newly Issued Securities (Section 32-38)
http://www.sec.or.th/laws_notification/Content_0000000312.jsp?categoryID=CAT000015&lang=en
Division 2 Debentures (Section 39-40)
http://www.sec.or.th/laws_notification/Content_0000000313.jsp?categoryID=CAT000015&lang=en
Division 3 Issue of Secured Debentures (Section 41-49)
http://www.sec.or.th/laws_notification/Content_0000000314.jsp?categoryID=CAT000015&lang=en
Division 4 Register and Transferability (Section 50-55)
http://www.sec.or.th/laws_notification/Content_0000000316.jsp?categoryID=CAT000015&lang=en
Division 5 Disclosure of Information and Auditor (Section 56-62)
http://www.sec.or.th/laws_notification/Content_0000000317.jsp?categoryID=CAT000015&lang=en
Chapter 3 Public Offering of Securities (Section 63-89)
http://www.sec.or.th/laws_notification/Content_0000000318.jsp?categoryID=CAT000015&lang=en
Division 4 Listed Securities (Section 189-200)
http://www.sec.or.th/laws_notification/Content_0000000305.jsp?categoryID=CAT000015&lang=en
Chapter 6 Over-the-Counter Centre and Futures and Options Centre
Division 1 Over-the-Counter Centre (Section 204-217)
http://www.sec.or.th/laws_notification/Content_0000000280.jsp?categoryID=CAT000015&lang=en
Chapter 7 Institutions Related to Securities Business
Division 1 Clearing House, Securities Depository Centre and Securities Registrar (Section 219-229)
http://www.sec.or.th/laws_notification/Content_0000000283.jsp?categoryID=CAT000015&lang=en

The Securities and Exchange Act B.E. 2535 prohibits companies from offering newly issued shares and other securities for sale without prior approval from the SEC in compliance with the rules and regulations issued by the SEC Board except for the rights offering to existing shareholders.
This provision allows the SEC to put in place rules and regulations and consider the merits of the securities to be offered.

Securities offering can be classified by types of securities as follows:

a. Shares
b. Derivative warrants
c. Debt Securities
d. Overseas Debentures
e. Warrants
f. Securitization
g. Securities Issuance and Offering by Foreign Issuer
h. Fx bond
i. Sukuk

On the other hand, Private Placement of Debt Securities which is exempt from SEC filing for registration is defined in the following Notification.
Notification of the Capital Market Supervisory Board No.TorChor.9/2552
Re: Application for and Approval of Offer for Sale of Newly Issued Debt Securities
http://capital.sec.or.th/webapp/nrs/data/4607se.pdf

2. Disclosure of Information

In offering newly issued securities for sale, companies shall apply for an approval from the SEC and disclose information to the investing public for decision making. However, the offering of existing securities by its holders can be done without the SEC approval on the condition that the offerors shall disclose information prior to offering securities for sale.

Before offering securities to the public, the offerors who can be companies or existing shareholders shall file a registration statement and a draft prospectus to the SEC to give investors time to study such information.

However, some types of securities offering are not required to file such documents if the offering does not affect the general public.

The offering of securities for sale is allowed upon:

a. The SEC approval in case of newly issued shares; and
b. The effectiveness of the registration filing. During the filing process, information shall be disclosed with discretion and within the limit of permitted scope.

3. Post-Offering Duties

After offering securities for sale to the public, companies shall undertake securities settlement with the holders in accordance with the SEC regulations and disclose information on a continual basis to give investors information for making investment decision.

Information of securities subject to public disclosure includes:

a. Report of securities selling
b. Report of rights exercising on convertible securities, i.e., warrants and convertible debentures
c. Report of financial condition and operational performance, consisting of financial statements and annual reports (Form 56-1 and 56-2)
d. Report of securities holding of the issuing company management

4. Regulatory transaction reporting requirements

The SEC stipulates that all licensed dealers must report transactions of each bond to the ThaiBMA within 30 minutes after trade.

Practically, trades are submitted to ThaiBMA within 15 minutes on average. All reports are scrutinized by the Monitoring and Surveillance department to ensure accuracy and integrity prior to compilation and dissemination to the general public and for the mark-to-market purpose.

C. Filing and Approval criteria (To be confirmed)

1. Plain debt

<table>
<thead>
<tr>
<th>Filing</th>
<th>1. Public Offering (PO)</th>
<th>✓</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>2. Non Resident Investor (NRI)</td>
<td>✓</td>
</tr>
<tr>
<td></td>
<td>3. Exempt</td>
<td>Min. disclosure</td>
</tr>
<tr>
<td></td>
<td></td>
<td>&lt; 10 persons</td>
</tr>
<tr>
<td></td>
<td></td>
<td>T-bill, Gov't bond, MOF bond, BOT bond</td>
</tr>
</tbody>
</table>

Filing means that SEC filing of the registration statement and draft prospectus.

2. Complex debt

<table>
<thead>
<tr>
<th>Filing</th>
<th>1. PO</th>
<th>✓</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>2. NRI</td>
<td>✓</td>
</tr>
<tr>
<td></td>
<td>3. Exempt</td>
<td>Min. disclosure</td>
</tr>
<tr>
<td></td>
<td></td>
<td>&lt; 10 persons</td>
</tr>
<tr>
<td></td>
<td></td>
<td>T-bill, Gov't bond, MOF bond, BOT bond</td>
</tr>
</tbody>
</table>

SEC Approval criteria

1. Plain Debt

1.1. PO

1.1.1. Eligible entities

1.1.2. Others

Local Issuer

- Bath bond & FX bond:
  - 1. Never breach to offering rule
  - 2. Qualified executive w/o prohibited qualification
  - 3. Disclose the latest annual and quarter F/S (มาตรฐานบมจ)
  - 4. Rated by accepted CRA
  - 5. Register with Thai Bond Market Association
  - 6. FX bond: issuer required approval from BOT in relation to FX control (additional)

Foreign Issuer

- Bath bond: approval from MOF
- FX bond:
  - 1. Never breach to offering rule
  - 2. Disclose financial status (IFRS/FASUS/GAAP/other acceptable standard)
  - 3. Contract person in Thailand
  - 4. Offering debt in Thailand is not beach the issuance’s country law
  - 5. IOSCO-signatory A
  - 6. Issuer required approval from BOT in relation to FX control

1.2. NRI

3 Baht bond: International financial institution or foreign government or multi-national corporation in ASEAN+3 countries
### SEC Approval criteria

<table>
<thead>
<tr>
<th>Thailand</th>
</tr>
</thead>
<tbody>
<tr>
<td>Lighter</td>
</tr>
</tbody>
</table>

#### 1.2.1. Eligible entities

- local company & foreign company

#### 1.2.2. Others

1. limited transferability
2. Rated by accepted CRA
3. Register with Thai Bond Market Association
   (< 10 persons, issuer is not required to comply 2. and 3.)

#### 2. Complex

| local securities, local/foreign securities index, currency, gold, cash in/out flow, credit link, credit default |

2.2. PO

- Underlying
  - **local securities, local/foreign securities index, currency, gold, cash in/out flow, credit link, credit default**

2.2.1. Eligible entities

- Local company
  - derivative dealer
  - Commercial bank (underlying = gold, FX)
  - cash in/out flow or main business are related to the reference underlying

2.2.2. Others

1. Never breach to offering rule
2. Qualified executive w/o prohibited qualification
3. Disclose the latest annual and quarter F/S (มาตรฐานบัตรพับ)
4. Rated by accepted CRA
5. Register with Thai Bond Market Association
6. Redeemed value > 80% of par value
7. Issuer is not a related party of the underlying company.

2.3. NRI

- Underlying

2.3.1. Eligible entities

- Local company
  - derivative dealer

2.3.2. Others

1. limited transferability
2. Rated by accepted CRA
3. Register with Thai Bond Market Association
   (< 10 persons, issuer is not required to comply 2. and 3.)

### 3. Is the following regimes is in place in jurisdiction?

<table>
<thead>
<tr>
<th>Private Placement Regime</th>
<th>YES</th>
<th>NO</th>
</tr>
</thead>
<tbody>
<tr>
<td>Institutional Offerings Regime</td>
<td>X</td>
<td></td>
</tr>
<tr>
<td>Integrated Disclosure Regime (Including continuous disclosure)</td>
<td>X</td>
<td></td>
</tr>
<tr>
<td>Shelf Registration Regime</td>
<td>X</td>
<td></td>
</tr>
</tbody>
</table>

### 4. Minimum lead time (number of business days) for registration approval

<table>
<thead>
<tr>
<th>How long is the time period set which the regulator has to approve or disapprove the prospectus?</th>
<th>TIME PERIOD (MONTHS)</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Offering corporate bond to II&amp;HNW effective within the next business day as from the date of filing prospectus in full.</td>
<td></td>
</tr>
<tr>
<td>• Offering Corporate Bond to Public (Public offering) effective after the end of the fourteen day period as from the day the office receives prospectus in full.</td>
<td></td>
</tr>
</tbody>
</table>

| How long in average is the prospectus reviewing period in your jurisdiction? (From the time of application until the approval/disapproval by the regulator) | About 20-30 days. |

### 5. Summary of regulation for issuing and offering of corporate bonds

Corporate bond offering regulations can be summarized as follows; *(To be confirmed)*

<table>
<thead>
<tr>
<th>Private Placement (PP)</th>
<th>Public Offering (PO)</th>
</tr>
</thead>
<tbody>
<tr>
<td>PP (Narrow Distribution/Small Size/Short term)</td>
<td>PP (II&amp;HNW/I)</td>
</tr>
<tr>
<td>Distribution</td>
<td>Institution investor &amp; High General investors</td>
</tr>
</tbody>
</table>

4 An integrated disclosure regime which allows the issuer to incorporate by reference continuous disclosure documents into its public offering documents, thereby easing disclosure burden of public offerings. It allows the qualified issuer to file disclosure documents for a new public offer by incorporating continuous disclosure documents by reference and minimizes the redundancies.
<table>
<thead>
<tr>
<th>Issue size</th>
<th>SEC Filing of the registration statement and draft prospectus</th>
<th>SEC Filing Required but Light (Free form, 1-day process)</th>
<th>SEC Filing Required (full form, full process)</th>
</tr>
</thead>
<tbody>
<tr>
<td>In case of Small (less than 100 million Baht), Cannot be listed (Unlisted)</td>
<td>SEC Filing Not required (Exempt)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Not less than 100 million Baht - can be listed.</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Not less than 100 million Baht - can be listed</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

**Short term bills**

<table>
<thead>
<tr>
<th>SEC Filing</th>
<th>Rating</th>
<th>ThaiBMA registration</th>
<th>Bond representative</th>
</tr>
</thead>
<tbody>
<tr>
<td>SEC Filing Not required (Exempt)</td>
<td>Not required (Exempt)</td>
<td>Not required (Exempt)</td>
<td>Not required (Exempt)</td>
</tr>
<tr>
<td>SEC Filing Required but Light (Free form, 1-day process)</td>
<td>Required, but Issue, Issuer, Guarantor rating (any can be used)</td>
<td>Required (newly issued bond)</td>
<td>Required (newly issued bond)</td>
</tr>
<tr>
<td>SEC Filing Required (full form, full process)</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

**Consecutive Disclosure requirement**

<table>
<thead>
<tr>
<th>Rating</th>
<th>ThaiBMA registration</th>
<th>Bond representative</th>
</tr>
</thead>
<tbody>
<tr>
<td>Not required (Exempt)</td>
<td>Not required (Exempt)</td>
<td>Not required (Exempt)</td>
</tr>
<tr>
<td>Required, but Issue, Issuer, Guarantor rating (any can be used)</td>
<td>Required (newly issued bond)</td>
<td>Required (newly issued bond)</td>
</tr>
</tbody>
</table>

**SEC Filing Not required (Exempt)**

- An annual report is required to be filed with the SEC.

**Characteristics of Private Placement / Exempt Rule**

<table>
<thead>
<tr>
<th>Characteristics of Private Placement / Exempt Rule</th>
</tr>
</thead>
<tbody>
<tr>
<td>Notification of the Capital Market Supervisory Board No. TorChor. 9/2552</td>
</tr>
<tr>
<td>Re: Application for and Approval of Offer for Sale of Newly Issued Debt Securities</td>
</tr>
<tr>
<td><a href="http://capital.sec.or.th/webapp/nrs/data/4607se.pdf">http://capital.sec.or.th/webapp/nrs/data/4607se.pdf</a></td>
</tr>
<tr>
<td>Chapter 2 Private Placement of Debt Securities</td>
</tr>
</tbody>
</table>

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5 REGULATIONS OF THE STOCK EXCHANGE OF THAILAND Re: Listing of Debt Instruments as Listed Securities, 2004
http://www.set.or.th/dat/content/rule/en/BorJorRor0200_EN.pdf
Division 1 Characteristics of Private Placement

Clause 32 An offer for sale of bonds in any of the following manners shall be deemed private placement:

(1) An offer made to institutional investors or high net worth investors, excluding an offer made to institutional investors or high net worth investors with registration of transfer restriction among not exceeding ten investors within any four-month period which shall fall under (2);

(2) An offer made specifically to not exceeding ten investors within any four-month period;

In cases where the securities depository center, custodian, securities broker, securities dealer or any person holds bonds on behalf of other persons, the counting of the number of investors under the first paragraph shall be based on the real owner of such bonds.

(3) An offer made to the person being the company’s creditor prior to the offer for sale of bonds for the purpose of debt restructuring;

(4) An offer granted an exemption from the Office, where the approved person shall demonstrate that:

(a) There is reasonable and appropriate cause;
(b) Such offer for sale shall not affect investors at large; and
(c) There are sufficient measures for investor protection.

Clause 33 In case of requesting an exemption for an offer for sale of newly issued bonds under Clause 32(4), the person requesting an exemption shall demonstrate the reasonable and appropriate cause of such case, the non-existence of effects on investors at large and the availability of sufficient measures for investor protection, and the Office may grant an exemption for application of the rules or conditions prescribed in this Chapter, whether totally or partially, to such offer for sale of bonds as deemed necessary, by taking into account the suitability and sufficiency of measures for investor protection.

Clause 34 Bills issued in any of the following manners shall be deemed issuance of bills for private placement:

(1) Bills issued by the securities finance institution or any other person as specified by the Office with the purpose to borrow money from institutional investors or high net worth investors;

(2) Short-term bills offered to institutional investors or high net worth investors;

(3) Bills which do not fall under (1) or (2) in the amount of not exceeding ten bills at any time when counting all types of bills issued by the company.

For the purpose of the provisions in this Clause, the term “institutional investor” under the first paragraph shall not include the persons prescribed in Clause 5(3) of the Notification of the Securities and Exchange Commission No. KorChor. 4/2552 Re: Exemption from Filing of Registration Statement for Offer for Sale of Debt Securities dated 13 March 2009.

Division 3 After-Approval Conditions for Private Placement of Debt Securities

Clause 37 In case of an offer for sale of all types of newly issued debt securities to institutional investors established under Thai law or high net worth investors under Clause 32(1), the approved person shall comply with the conditions under Clause 38, Clause 39 and Clause 40.

Clause 38 Prior to each offer for sale of newly issued debt securities, the approved person shall provide any of the following credit rating arrangement by the credit rating agency approved by the Office:

(1) Credit rating of debt securities offered for sale each time (issue rating);

(2) Credit rating of the debt securities guarantor (guarantor rating), only in cases where the guarantor is obliged to liabilities jointly with the debtor without revocability before the debt securities maturity, including credit rating of the provider of aval of principle and interest of bills in full amount without condition; or

(3) Credit rating of the approved person (issuer rating), excluding the case of an offer for sale of subordinated bonds.

The provisions related to granting of exemption for credit rating arrangement as prescribed in the second paragraph of Clause 21 shall also apply to the case under the first paragraph.

Clause 39 After the issuance of debt securities, the approved person shall provide continuous arrangement of credit rating of debt securities in accordance with the rules under Clause 38 until the claim for repayment of such debt securities is terminated. Except where it is necessary and appropriate, the Office may grant an exemption for arrangement of credit rating of debt securities and may also prescribe the timeframe or conditions thereof, by taking into consideration the necessity of credit rating information for investors.

Clause 40 The approved person shall file an application with the Thai Bond Market Association for registration of the issued and offered debt securities within thirty days after the issuing date.
Clause 41 In case of an offer for sale of short-term bonds or bills to institutional investors or high net worth investors, the approved person may make unlimited offer for sale of short-term bonds or bills subject to the registration statement filed for an offer for sale of short-term bonds or bills to institutional investors or high net worth investors as prescribed in the Notification of the Capital Market Supervisory Board concerning filing of registration statement for offer for sale of debt securities, but any offer shall be made within one year after the effective date of such registration statement.

Division 4 Additional After-Approval Conditions for Private Placement of Bonds

Clause 42 Prior to an offer for sale of bonds, the approved person shall obtain an explicit resolution from the company's board of directors approving the issuance of bonds. Except where the applicant is a public limited company, the resolution for the issuance of bonds shall be obtained in compliance with the law on public limited company. The provisions in the first paragraph shall not apply to the case where the company is required to issue bonds according to the rehabilitation plan under the bankruptcy law which has been approved by the court, or any other case granted an exemption by the Office.

Clause 43 In case of secured bonds or bonds provided with the bond holder representative, the approved person shall provide the bond holder representative whose name is in the list of persons qualified to be the bond holder representative in accordance with the Notification concerning qualifications of bond holder representative and authority of bond holder representative.

Clause 44 The approved person shall take the following actions:

1. Having the bonds to be issued and offered for sale meet the following characteristics:
   a. Being registered bonds and having a statement in the certificate of bonds offered for sale each time that the bond issuer shall not accept transfer registration of bonds in any level if such transfer is inconsistent with the transfer restriction as indicated and registered with the Office;
   b. Having the characteristics in accordance with Clause 17(1), (2) and (3);
   c. Complying with the rules prescribed in Clause 18 and Clause 19 in case of an offer for sale of subordinated bonds or perpetual bonds, as the case may be;
   d. In case of an offer for sale of bonds to institutional investors established under Thai law or high net worth investors under Clause 32(1), having the terms and conditions with at least the particulars as prescribed in Section 42(1) to (9) and complying with the first paragraph of Clause 29;
2. In case of private placement of bonds under Clause 32(2), (3) or (4), the approved person shall not advertise an offer for sale of newly issued bonds and reserved shares. If the distribution of offer documents is made, the approved person shall distribute such documents only to persons with the characteristics or in the limited number as prescribed in Clause 32(2), (3) or (4) as granted approval;
3. Offer documents (if any) shall contain a statement indicating the transfer restriction under (1)(a) and in case of an offer for sale of subordinated bonds, such subordination shall be clearly indicated.

Clause 45 In cases where any person shows his intention to the approved person to register transfer of bonds, the approved person shall make verification of such transfer. If such transfer is inconsistent with the transfer restriction registered with the Office, the approved person shall not register such transfer, except for transfer by inheritance.

In cases where the approved person has provided the bond registrar, the approved person shall have the bond registrar comply with the rules prescribed in the first paragraph.

Division 5 Additional After-Approval Conditions for Private Placement of Bills

Clause 46 Prior to an offer for sale of bills, the approved person shall obtain an explicit resolution from the company's board of directors approving the issuance of bills, except for the case where the company is required to issue bills according to the rehabilitation plan under the bankruptcy law which has been approved by the court or any other case granted an exemption by the Office.

Clause 47 The approved person shall provide a statement that "These bills are securities and approved for private placement" on the face of the bills. In case of the issuance of bills under Clause 34(1) or (2), the bill issuer shall provide additional statements saying "Being offered for sale only to institutional investors or high net worth investors" and "Non-negotiable" or "With the purpose of transfer among institutional investors or high net worth investors" or any other statement with similar meaning.

Clause 48 In case of an offer for sale of bills under Clause 34(3), the approved person shall not advertise such offer. If the distribution of offer documents is made, the approved person shall distribute such documents only to persons with the characteristics or in the limited number as prescribed in Clause 34(3) as granted approval.

Notified this 13th day of March 2009.

Remark: The rationale for issuing this Notification is to prescribe rules on approval of an offer for sale of newly issued debt securities by a company established under Thai law or a branch of a foreign commercial bank and, so as to promote
development and growth of Thai debt securities market, to relax rules on approval of an offer for sale of debt securities to limited group of investors which will help facilitate fund raising through debt securities issuance of the private sector, as well as to re-define an offer for sale to limited group of investors to include an offer for sale of debt securities to institutional investors or high net worth investors without limitation of offer value to be in accordance with international standards.

Exemption from Filing of Registration Statement for the Offer for Sale of Debt Securities

Re: Exemption from Filing of Registration Statement for the Offer for Sale of Debt Securities
http://capital.sec.or.th/webapp/nrs/data/4603se.pdf

Chapter 1 Debt Securities under Exemption

Clause 5. The provisions under Chapter 3 of the Securities and Exchange Act B.E. 2535 (1992) concerning public offering of securities shall not apply to the following debt securities:

(1) corporate bonds where principle and interest are guaranteed by the Ministry of Finance, but not including convertible bonds;

(2) debt securities offered for sale by securities companies licensed to undertake securities business in the category of securities dealing where the issuer has adequately provided continual information disclosure;

(3) bills issued and offered for sale with the purpose to borrow money from the following persons:
   (a) commercial banks, finance companies or credit foncier companies under the law on financial institution business;
   (b) financial institutions established under specific law;
   (c) any other person prescribed by the Office.

D. BEX’s rules related to bond listing, disclosure, trading

http://www.set.or.th/set/notification.do?idLv1=7&idLv2=57&language=en&country=US

NOTIFICATION OF THE STOCK EXCHANGE OF THAILAND
Re: Trading of Debt instruments, 2003
http://www.set.or.th/dat/content/rule/en/BorSorSaw0114_1_EN.pdf

REGULATIONS OF THE STOCK EXCHANGE OF THAILAND
Re: Listing of Debt Instruments as Listed Securities, 2004
http://www.set.or.th/dat/content/rule/en/BorJorRor0200_EN.pdf

E. ThaiBMA’s rules related to trading, reporting, and registration

http://www.thaibma.or.th/sro/TBMArule_Eng.htm
http://www.thaibma.or.th/sro/TBMArule.htm

Standard of Practices for the Bond Market

F. BOT’s Regulations on Non-resident

Non-residents may invest in TGBs without any restrictions. Repatriation of investment funds and returns on such investment can be freely remitted upon submission of supporting evidences to authorised financial institutions in Thailand.

Investment in TGBs is also eligible for foreign exchange hedging with authorised financial institutions in Thailand.

Transfers in Thai Baht relating to investment in TGBs must comply with the present Foreign Exchange Regulations governing Non-Resident Baht Accounts.
G. Credit rating requirements

Credit rating is required for corporate bonds Public Offering (PO) or Private Placement (PP) as stated above II.C.5.

<table>
<thead>
<tr>
<th>Rating Agency</th>
<th>Rating</th>
<th>Date</th>
</tr>
</thead>
<tbody>
<tr>
<td>S&amp;P</td>
<td>BBB+</td>
<td>Dec 2010</td>
</tr>
<tr>
<td>Moody's</td>
<td>Baa1</td>
<td>Oct 2010</td>
</tr>
<tr>
<td>Fitch</td>
<td>BBB</td>
<td>Apr 2010</td>
</tr>
<tr>
<td>R&amp;I</td>
<td>BBB</td>
<td>Apr 2011</td>
</tr>
</tbody>
</table>

Global rating agencies have assigned the above long-term foreign currency ratings for Thailand.

The Securities and Exchange Commission (SEC) licenses rating agencies that specialize in Thai debt.

Rating definitions vary from agency to agency.

Rating selection involves information gathering, analysis, and monitoring of the financial health of an issuing entity.

The TRIS Rating Co., Ltd. (TRIS Rating) covers financial institutions, private companies, and state enterprises. Users can also find information on the rationale for each rating level.

H. Exemptions for private issues (private placement)

See above II.C.5.

The corporate bond offering which offers to less than 10 persons will be exempted from the obligation to file the disclosure documents to SEC to offer or sell securities.

Private placement, PP, where the offer is made to (1) fewer than 10 investors or (2) the issue size is less than 100 million Baht, (3) the bonds are offered to a limited group of investors, particularly institutional investors.

In reality, in the PP market, there is a condition in the secondary market that only allows institutional investors to buy and sell these bonds. This type of bond is negotiated and trade off the Exchange floor, referred to as an “Over-the-Counter (OTC).”

I. Minimum lead time (number of business days) for registration approval

See above II.C.3-4.

J. Availability of shelf registration and associated documentation requirements

See above II.C.3 and the SEC Act B.E. 2535 Chapter 3 Public Offering of Securities (Section 63-89)

http://www.sec.or.th/laws_notification/Content_0000000318.jsp?categoryID=CAT000
K. Regulated suspension period (this may relates to investor protection)

See above II .C.3-4.

The SEC Act B.E. 2535 Chapter 3 Public Offering of Securities Section 67: Subject to the provisions of Section 68, a registration statement and draft prospectus shall be effective upon the lapse of forty-five days after the receipt of such registration statement and prospectus by the Office, except where the SEC specifies an effective date before such period.

L. Other requirements

Rating requirement is unique to Thailand.

M. Continuous disclosure rules or requirements

See above II .C.3-5.

N. Restrictions for investors (investment grade, etc.)

As the market entry requirements, there are no government restrictions to investors investing in the Thai bond market.

See I .K.1-2 above.

O. Definition of Qualified Institutional Investors, Professional Investors, if exist

Definition of Institutional investors and High net worth investors are clearly defined here.

Notification of the Securities and Exchange Commission No.KorChor.5/2552
Re: Determination of Definitions in Notifications relating to Issuance and Offer for Sale of Debt Securities

%3A%2F%2Fcapital.sec.or.th%2Fwebapp%2Fdata%2F4604se.pdf&ei=Ob -Tf
DxKlfCvgPYmJyYAw&usg=AFQjCNEY6hzWoGDDqBFVMs-PNWUt6pOg

Clause 3 In this Notification and the forms attached with the Notifications under Clause 2:

(2) definitions relating to type of investors:

(a) “institutional investors” means:

1. commercial banks;
2. finance companies;
3. securities companies for management of proprietary portfolios or private funds or investment projects established under laws governing finance business, securities business and credit foncier business;
4. credit foncier companies;
5. insurance companies;
6. government units and state enterprises under laws governing budgetary procedures or any other juristic persons established under specific laws;
7. Bank of Thailand;
8. international financial institutions;
9. Financial Institutions Development Fund;
10. Government Pension Fund;
11. provident funds;
12. mutual funds;
13. foreign investors with the same characteristics as investors under (1) to (12), mutatis mutandis;

(b) “high net worth investors” means:

1. individual persons having forty million baht or more of assets, excluding liabilities of such persons;
2. juristic persons having two hundred million baht or more of assets as recorded in the latest audited financial statements;

P. Non-resident requirements / restrictions

As the market entry requirements, there are no government restrictions to Foreign investors investing in the Thai bond market.

But there are a couple of restrictions.

Foreign Exchange Control related restrictions related to the Exchange Control Act B.E. 2485 (1942):

The legal basis for exchange control in Thailand is derived from the Exchange Control Act (B.E. 2485) and Ministerial Regulation No.13 (B.E. 2497) issued under the Exchange Control Act (B.E. 2485).

These laws set out the principles of controlling, restricting, or prohibiting the execution of all exchange or other operations in which foreign currency is concerned in whatever form.

The foreign exchange controls are issued under the act with following major objectives:-

1. To centralize foreign exchange of the country
2. To channel foreign exchange for public benefit
3. To monitor capital outflows
4. To stabilize the value of Baht

a. Foreign Currency Restriction

Foreign currencies can be brought into Thailand without any limitations.

Any person receiving foreign currencies from abroad is required to sell such foreign currencies to an authorized financial institution or to deposit them in a foreign currency account with an authorized financial institution within 360 days from receiving date, except for foreign embassies, international organizations and foreigners temporarily staying in Thailand for not exceeding 3 months.

Foreign exchange purchase or hedging with authorized financial institutions is generally available where a genuine underlying current or capital transaction exists.

b. Local Currency Restriction
There is no restriction on the amount of Baht that may be brought into the country. A person travelling to Thailand’s bordering countries including Vietnam is allowed to take out Baht up to THB 500,000 (USD 15,000) and to other country up to THB 50,000 (USD 1,500) respectively without authorization.

c. Measures to prevent Thai Baht speculation

i. Measures to limit Thai Baht Liquidity

Domestic Financial Institutions are limited to provide Thai Baht Liquidity to Non-resident (NR) in the case of transaction undertaken without underlyings, the total outstanding balance executed by each financial institution shall not exceed THB 300 million (USD 8 million) per group of NRs.

ii. Measure to curb Capital Inflows

Domestic Financial Institutions are limited to borrowing or undertaking transactions comparable to Thai Baht borrowing from NRs in the case of transaction undertaken without underlying, the total outstanding balance executed by each financial institution shall not exceed THB 10 million (USD 3 million) per group of NRs.

iii. Measure on NRBA account and NRBS account

Non Resident Baht Account (NRBA) and Non Resident Baht Account for Securities (NRBS) are limited to outstanding balance at the end of each day not exceeding THB 300 million (USD 8 million) per NR which included balances of all accounts opened by each NR across all domestic financial institutions in Thailand.

Domestic Financial institutions are also refrain from paying interests to each account except for the NRBA fixed account with maturities of 6 months or over.

iv. Measure on Non-Deliverable Forward (NDF)

Domestic Financial Institutions are not allowed to undertake NDF transactions against Thai Baht with Non-residents.

Q. Taxation Framework and Tax requirements

Residents and non-residents investing in the Thai market are charged withholding tax on dividends and fixed income as follows:

<table>
<thead>
<tr>
<th>Duties and Tax</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>Withholding Tax (WHT)</td>
<td></td>
</tr>
<tr>
<td>WHT - Equities</td>
<td>10% on dividend</td>
</tr>
<tr>
<td>WHT - Fixed Income</td>
<td>15% on interest</td>
</tr>
<tr>
<td>Capital Gains</td>
<td>0 - 15% subject to Double Tax Agreements (DTA)</td>
</tr>
<tr>
<td>Stamp Duty</td>
<td>No (Stamp duty is only applied to physical certificate of non-listed securities at a rate of THB 1 for every THB 1,000 of the trade counter-value (OTC).)</td>
</tr>
<tr>
<td>Other Taxes</td>
<td>Value Added Tax (VAT) is 7%</td>
</tr>
</tbody>
</table>

1. Withholding Tax

The tax liability of incomes from investments in debentures, which are classified in 3 categories; (1) Interest Income, (2) Capital Gain and (3) discount or the difference between the redemption price and bid price and bid price in the case of debentures that yield no interest but are sold at below the redeemed value.
The tax is determined by the type of income, and the nature of the investor or income earner.

Generally, payers withhold income tax upon payment at rates of 15% on natural persons, 1% on juristic persons and 10% on foundations or associations.

Payments made to banking institutions, securities or other semi-banking institutions are liable to a 3.3% specific business tax.

Investments in debenture of mutual funds are exempt from income tax on the capital gains because mutual funds are juristic persons separate from fund management institutions.

All benefits that mutual funds receive in interests, capital gains and discounts are exempt from tax computation.

But the unit-holders of investment in mutual funds are liable to income tax applicable to natural or juristic persons, as the case may be, on dividends or profit sharing of the investment units in the same manner as tax liability of investment in equity instruments.

2. Specific Business Tax

Specific Business Tax (SBT) is collected from individuals, groups of persons who are not juristic persons and any other justice persons, on incomes derived from engaging in business of banking, finance and securities, credit foncier, life insurance, pawn brokerage, semi-commercial banking and real estate.

Banking, financial and securities institutions pay SBT on income of interests, discounts, fees, service fees, and gross profits-before-expenses from transactions of any bills or debentures, foreign exchange, drafts or overseas remittance.

The SBT on incomes relative to bonds is levied at 0.01 percent, to be remitted to government authorities.

3. Double Taxation Agreement

Double Taxation Agreements are treaties signed by Thailand and various other countries which specify tax exemption on incomes derive from investments, whereby investors are only liable to income tax in one country to induce foreign investment.

The Double Taxation Agreement applies to persons who are residents of the Contracting States and applies to direct taxes, viz., personal income tax, corporate income tax and petroleum income tax.

Other indirect taxes such as value added tax, SBT, excise tax, etc., are not covered by the Double Taxation Agreement. The Double Taxation Agreement also prescribes a ceiling rate for tax collection which the source country must not exceed.

4. Tax Exemption for Non-resident investors

Under the Ministerial Notifications No.249 (B.E. 2548) and Royal Decree No.429 (B.E. 2548), individuals or juristic companies or partnerships established under foreign law
and not operating business in Thailand are exempted from income tax on the following assessable incomes:

a. Interests received from government agencies bonds.
b. The difference between redemption price and selling price of government agencies bonds issued and sold at the first time at the price lower than redemption price (discount).
c. Benefits received from the transfer of government agencies bonds (capital gain).

However, **withholding tax exemption on capital gain income of government securities trading has been revoked** since October 13, 2010 due to capital control measure.

5. Taxation Framework and Tax requirements summary

<table>
<thead>
<tr>
<th>Type of Bonds</th>
<th>Resident Investors</th>
<th>Nonresident Investors</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Interest Income</td>
<td>Capital Gains</td>
</tr>
<tr>
<td>Government &amp; Quasi Government Bonds (including SFIs)</td>
<td>Individual: 15% withholding tax (recipients can choose to include in calculation for the purpose of personal income tax)</td>
<td>Individual: 15% withholding tax (for zero coupon instruments, if 15% is prepaid, capital gains is tax exempt)</td>
</tr>
<tr>
<td></td>
<td>Corporate: 1% withholding tax</td>
<td>Corporate: Liable for corporate income tax</td>
</tr>
<tr>
<td>Corporate Bonds</td>
<td>Individual: 15% withholding tax recipients can choose to include in calculation for the purpose of personal income tax</td>
<td>Individual: 15% withholding tax except for zero coupon bonds. And can choose not to include in the year end income tax.</td>
</tr>
<tr>
<td></td>
<td>Corporate: Liable for corporate income tax</td>
<td>Corporate: 15% withholding tax</td>
</tr>
<tr>
<td>Supranational Bonds</td>
<td>Waived</td>
<td>Waived</td>
</tr>
<tr>
<td>Securitized Bonds</td>
<td>Individual &amp; Corporate: 15% withholding tax upon debenture interest payment</td>
<td>N/A</td>
</tr>
<tr>
<td></td>
<td>Individual &amp; Corporate: 15% withholding tax upon debenture interest payment</td>
<td>N/A</td>
</tr>
</tbody>
</table>
III. Trading of Bonds and Trading Market Infrastructure

A. Trading of Bonds

See “FSAP_fixed income markets” in part of Secondary Market Infrastructure, and Repo.

Bond trading in Thailand can take the form of either over-the-counter (OTC) or exchange traded.

Bonds are normally traded in a big lot and are infrequent as compared to equities.

As such, most bonds circulated in the secondary market are traded through OTC where by negotiation between buyer and seller.

Most of transactions take place over telephone or voice broker, rarely trading via electronic trading platform.

B. Trading Platforms

The Bond Electronic Exchange (BEX), a division of SET, was officially launched on November 26, 2003. BEX’s objective is to develop the secondary market for bond trading in Thailand.

BEX’s main roles are as follows:

a. Support the development of Thailand’s secondary bond market
b. Expand bond activities to smaller investors
c. Properly educate non-institutional investors of an additional investment instrument

To attract bond activities in both retail and wholesale markets, BEX has been granted the approval from the SET’s committee to include both government issues and corporate issues in its Exchange. BEX will also include Asian Bonds in its trading platform.

There are two trading methods for retail investors on BEX;

1. Automatic Order Matching (AOM)
2. Put Through (PT) for retail market when trading value crosses over 10,000 units (THB 10 million)

The BEX aims to expand bond activities to smaller investors and to educate non-institutional investors of additional investment products.

The SET allowed the BEX to include trading of both government and corporate issues in order to attract bond activities in retail and wholesale markets.

The SET now operates bond trading on both exchange platform (AOM: Automatic Order Matching) and non-exchange platform (FIRST: Fixed Income and Related Securities Trading System), which was aimed to serve fixed income dealers and institutional investors.

Institution and large scale investors will trade via “Fixed Income and Related Securities Trading System” on the exchange platform.
Trading System (FIRSTs)"

C. Bond Information Centre

The ThaiBMA serves as the information center in collecting and distributing information of the bond market.

The following SEC regulations support the role of ThaiBMA in performing as information center and SRO for the bond market;

1. All Public Offering and some Private Placement corporate bond issues must register at ThaiBMA. While there is no such regulation applied on government securities, in practice, all government bond issues are automatically registered at ThaiBMA.

2. All licensed dealers must report transactions of each bond to the Thai BMA within 30 minutes of trade. Then the data is disseminated on real-time basis through ThaiBMA website. [http://www.thaibma.or.th/aboutus/aboutus.html](http://www.thaibma.or.th/aboutus/aboutus.html)

Currently, ThaiBMA categorized reported data into three types to facilitate the analysis and follow-up of the bond market, and provide a fair and valid reference to the data as follows:

1. Outright transaction: a one-shot transaction under no obligation agreed upon in advance, such as the-sell-and-buy-back price, generally it refers to T+4 transactions that are handed over within 4 business days.

2. Financing transaction: under the repurchase agreement (repo) or sell-and-buy-back condition where bonds are treated as collateral.
3. Other transaction: any transaction other than the outright and financing transactions, such as transactions with prior agreements, transactions that are handed over after 4 business days, or transactions according to options or forward agreements, etc.

Transaction reports submitted to the ThaiBMA are scrutinised by the Monitoring and Surveillance Dept. prior to compilation and dissemination to the general public and for the mark-to-market process of bonds.

D. Government Bond Yield Curve and Bond Indices

ThaiBMA has developed the Government Bond Yield Curve by using bidding yields quoted daily by primary dealers and publish on the website on a daily basis. Additionally, Thai BMA publishes reference yields of the State-owned Enterprise (SOE) bonds, FIDF bonds and treasury bills. The yield curve information is disseminated to the public on a daily basis since 1999. This yield curve can be found on the Thai BMA’s website.

http://www.thaibma.or.th/yieldcurve/YieldTTM.aspx

In addition to the yield curve, ThaiBMA has also developed Bond index to be a tool to track market performance.

They comprise of Total Government Bond Index, Corporate bond index and Categorised Index which is divided into several subgroups by maturity e.g. 1-3 years, 3-7 years, 7-10 years and over 10 years.

ThaiBMA bond indices are publicly available on a daily basis.
E. Bond futures

In 2010 the Thailand Future Exchange (TFEX) has launched its first interest rate-based derivatives product called “bond futures”. Recently, there are three groups of bond future contract providing in the market which are short-term interest rate-based futures: 3M Bibor Future and 6M THBFIX Futures, and long-term interest rate-based future: 5 Y Gov. Bond Future.

F. Repo transactions

a. Repo transactions on corporate bonds is allowed

The eligible securities for repo transactions on bonds are mutually agreed between counterparties. It can be commercial papers, certificates of deposit, non-convertible debt, and convertible debt.

b. Entities that can participate in repo transactions

Any entities; Dealer, institutional investor, and retail investor can participate in repo transactions.

Any securities companies authorized by the SEC can participate in repo transactions. No regulation in place except: 1) RP with nonresident is available for Govt. bonds. 2) RP with retail investors is available only for Govt. bonds.

c. Margin requirements for participants entering repo transactions

Both parties (lender and borrower) have obligation to monitor market movement and are obligated to provide margin if price movement is greater than preset up threshold.

1. Market Value = Gross Price % X Current Par X No. of Units
2. Required Securities Value = (Purchase Price + Accrued Interest)/ (1 - Initial margin)
3. Threshold = ± 500,000 THBS
4. Market value < Required securities value
5. Margin exposure = Market value - Required securities value
6. Margin exposure > threshold => Call margin
Ⅳ. Possible item of Impediments / Restrictions

A. Impediments to the Thai Bond Market

1. Limitation of the Investor Base:
   Corporate investors remain few. Therefore, transactions are within the cluster of a small number of major investors. At the same time, retail investors lack a good knowledge or understanding of the bond market. They are more content with commercial bank deposits than other kinds of investment. At present, as the government provides unlimited guarantee on deposits at commercial banks, many depositors choose to accept a lower return for the security of their deposits. However, the government has already endorsed the setting up of a Deposit Insurance Agency (DIA). As a consequence, there should be a shift of deposits away from small banks and some of them should flow into the bond market.

2. Few Bond Issuances by the Private Sector:
   Currently, there are just over one hundred private enterprises who issue bonds. These are comparatively few, compared to the companies listed on the SET. One other reason is that commercial banks try to offer loans at low interest rates and under attractive conditions to maintain their corporate customers of good credit standing. Therefore, these companies do not see the benefit of bond issuance in reducing costs.

B. Significant factors

The following are the factors that are considered to be the main inhibiting obstacles against the development of corporate bond market. A scale from 1-5 is from the least significant factor to the most significant factor.

<table>
<thead>
<tr>
<th>Factors</th>
<th>scale</th>
</tr>
</thead>
<tbody>
<tr>
<td>Availability of easy and cheap bank loans/competition from banks against the corporate bond market</td>
<td>5</td>
</tr>
<tr>
<td>Buy and hold strategy adopted by investors</td>
<td>5</td>
</tr>
<tr>
<td>Lack of efficient market making system</td>
<td>3</td>
</tr>
<tr>
<td>Differential treatment in favor of government bonds / loans (such as differential tax treatment in favor of government bonds / loans.)</td>
<td>3</td>
</tr>
<tr>
<td>Unstable political and macroeconomic environment</td>
<td>3</td>
</tr>
<tr>
<td>Investors’ conservative approach to corporate bond market</td>
<td>3</td>
</tr>
<tr>
<td>Lack of retail participation</td>
<td>3</td>
</tr>
<tr>
<td>Riskiness of the instrument and risk aversion of investors</td>
<td>3</td>
</tr>
<tr>
<td>Lack of hedging instruments against market risks</td>
<td>2</td>
</tr>
<tr>
<td>Crowding out by large governmental borrowings</td>
<td>2</td>
</tr>
<tr>
<td>Lack of liquidity attributes in secondary market and opacity of secondary market</td>
<td>2</td>
</tr>
<tr>
<td>Lack of efficient trading, clearing and settlement mechanisms</td>
<td>2</td>
</tr>
<tr>
<td>Inadequate price transparency (such as inadequate reporting requirements in OTC bond markets or non-existence of price vendors to support the valuation process in the corporate bond markets)</td>
<td>2</td>
</tr>
<tr>
<td>Inadequate savings level for investment in corporate bond market</td>
<td>1</td>
</tr>
<tr>
<td>Inefficient and expensive primary market (High issuance costs, costly disclosure requirements, etc. in issuance process)</td>
<td>1</td>
</tr>
<tr>
<td>Protracted pre-launch reviewing period and lengthy approval time</td>
<td>1</td>
</tr>
<tr>
<td>Insufficient information disclosure by issuers</td>
<td>1</td>
</tr>
<tr>
<td>Lack of advanced, economical and less burdensome securities offering methods for institutional investors (traditional private placements, institutional offerings, integrated disclosure, self-registration and other hybrid regimes)</td>
<td>1</td>
</tr>
<tr>
<td>Lack of a benchmark yield curve from government bond issuance in pricing the corporate bond issues</td>
<td>1</td>
</tr>
</tbody>
</table>
V. High level description of the securities settlement system

The information contains in a separate file - “FSAP_RSSS May2009”.

A. Securities settlement infrastructure

As both depository and registrar, the Bank of Thailand (BOT) is responsible for the settlement of government bonds. In 2001, BOT’s real time gross settlement (RTGS) system – THBNET - was restructured to incorporate delivery-versus-payment facilities on all government securities.

Most corporate bonds are cleared and settled at a Stock Exchange of Thailand (SET) subsidiary - the Thailand Securities Depository Co. Ltd (TSD).

1. TSD and Book-entry system for debt instruments

TSD provides in-house development system called PTI (Post Trade Integrated) as Book entry system to TSD’s members.

The functions on PTI system include Custody, Clearing & Settlement and Submission of list of bondholders to The Bank of Thailand.

The system aims to provide the settlement mechanism for both Deliver/Receive Versus Payment (DVP & RVP) and Deliver/Receive Free (DFRF). CSD’s members can submit the settlement orders via SWIFT messages or PTI system.

PTI: Post Trade Integration

The Stock Exchange of Thailand has successfully implemented the Post Trade Integration (PTI). PTI is designed based on new technology that supports Straight Through Processing (STP), connecting it with external systems automatically via global message standard. In addition, it integrates all financial instruments – equity, debenture and government bond – into one system. The introduction of PTI will help to improve efficiency and effectiveness of business operation and risk management.

Having gone live PTI lived in October 2007, PTI replaces SDC and SRG that supported after trade services from securities clearing & settlement to securities depository and from securities registration to risk management of clearing house. Besides improving performance of after-trade systems, PTI enables a variety of value added services such as real time linkage with Bank of Thailand, equity’s Securities Borrowing & Lending (SBL), and the most recent service introduced by TSD, Repurchase Agreement (REPO). PTI not only supports but is also central to TSD. PTI focuses are performance, cost reduction and automated processes.

Built on modern technology and global standard, PTI’s capabilities are enhanced in many aspects including:

Ease of use and setup of new user interfaces designed based on web-based technology and utilize CITRIX to both provide fast response and reduce bandwidth cost.
Message specification is based on ISO 15022 standard.
Real time linkage with Bank of Thailand’s BAHTNET system and SWIFTNet to reduce risks, attaining the highest level of efficiency and meeting the international standards.
of clearing & settlement such as DVP/RVP transactions via real time gross settlement.

Automate business processes - Transaction Automation which reduces errors from human intervention.
Online business reports with ability to export them in standard format.

Information of PTI (As of January 31, 2008)

<table>
<thead>
<tr>
<th>PTI member</th>
<th>96</th>
</tr>
</thead>
<tbody>
<tr>
<td>Securities using registration services</td>
<td>577</td>
</tr>
<tr>
<td>Settlement value (average per day)</td>
<td></td>
</tr>
<tr>
<td>Equity</td>
<td>3,302 MB</td>
</tr>
<tr>
<td>Government bond</td>
<td>196,509 MB</td>
</tr>
<tr>
<td>Depository value (scripless)</td>
<td></td>
</tr>
<tr>
<td>Equity</td>
<td>4,030,748 MB</td>
</tr>
<tr>
<td>Government bond</td>
<td>2,540,153 MB</td>
</tr>
<tr>
<td>Registered capital amount of registrar members</td>
<td>1,995,157 MB</td>
</tr>
</tbody>
</table>

2. DVP and RTGS mechanism

CSD applies DVP and RTGS only with Gross settlement. DVP shall be exploited between CSD and CSD’s members. RTGS shall be implemented between CSD and the Bank of Thailand (BOT). The Process shall be described as in the following.

a. Receive Orders from the PTI system and automatically check the availability of such securities in the specified depository account provided by the members.
b. Hold such securities until the system is acknowledged the payment confirmation
c. Submit the payment requests to BOT through RTGS.
d. BOT makes the money clearing by submitting the payment confirmation back to PTI system. The details shall specify that BOT has deducted money from the purchaser bank account and deposited into the seller bank account.
e. PTI shall transfer hold securities to purchaser’s depository account as specified.

3. Post-trade matching mechanism

Post-trade only provides the matching mechanism for the OTC transactions as Gross-Gross settlement.

Thence, TSD sets the criteria for post-trade matching mechanism for Gross-Gross settlement by using 6 fields as follows:

a. Settlement Date
b. ISIN code
c. Amount of securities
d. Sender’s depository account
e. Receiver’s depository account
f. Amount of Payment

However, for Deliver/Receive Free (DFRF), TSD will use only 5 fields for matching mechanism. The details are as follows:

a. Settlement Date
b. ISIN code
c. Amount of securities
d. Sender’s depository account
e. Receiver’s depository account
4. Execution matching mechanism

Thailand has applied execution matching mechanism both OTC market and the exchange.

In principle, for Net settlement as occurred on the Exchange, TSD receives the matching information directly from trading system executing by the Exchange. For Gross Settlement as occurred on the OTC market, TSD applies in-house development software called PTI (Post Trade Integrated) as execution matching mechanism.

5. Settlement scheme for Corporate Bond, Government Bond and other debt securities

   a. Gross-Gross for the OTC Market
   b. Net-Net for the Exchange

6. Settlement cycle for Corporate Bond, Government Bond

   a. For OTC Market, It is a real time since TSD applies RTGS and DVP.
   b. For the Exchange, It is T+2.

B. Bond settlement infrastructure diagram (Thailand)

![Diagram of Bond Settlement Infrastructure]

BEX – The Bond Electronic Exchange (The Stock Exchange of Thailand)
PTI – Post Trade Integration (The Stock Exchange of Thailand)
TSD – Thailand Securities Depository (The Stock Exchange of Thailand)
TCH – Thailand Clearing House (The Stock Exchange of Thailand)
BAHTNET – The Bank of Thailand Automated High-value Transfer Network
MNS – Multilateral Netting System

C. Brief history of the development of the Securities settlement infrastructure

Prior to the Year 2006, the clearing and settlement have been executed at the Bank of Thailand both in physical and dematerialized securities.

In 2006, CSD has migrated the clearing and settlement of dematerialized securities (all...
types of debt instruments) to be in CSD system as known “PTI system”.

However, the Bank of Thailand is responsible for the clearing and settlement of physical securities.

In addition, money clearing both in dematerialized and physical securities must be performed by the Bank of Thailand.

Until now, it is the current platform of the clearing and settlement of Thailand.

CCP function for securities has been transferred from Thailand Securities Depositories Company (TSD) to Thailand Clearinghouse Company (TCH), which acts as CCP for derivatives, since February 2010. TCH is legal entity of clearing house for both stock and bond regardless of SET or OTC trading. [http://www.thaiclearing.com/en/PublicRelation/20100211-12.pdf](http://www.thaiclearing.com/en/PublicRelation/20100211-12.pdf)

In addition to the centralization of trading system, the Domestic Bond Market Development Steering committee also stipulated the integration of depository, clearing and settlement system at the Thailand Securities Depository Co., Limited (TSD), a SET subsidiary.

However, while TSD is responsible for the depository, clearing and settlement of scrippless debt securities, transfer of funds is handled by the BAHTNET system of the BOT.

TSD acts as center for transfer and payment of debt securities through 2 channels, namely, TSD Web Service (Post Trade Integration: TPI) for NON-SWIFT members of TSD and SWIFT Network for SWIFT members.

Debt securities clearing and settlement services provided by TSD meets the international standard according to Group of 30 (G30) Recommendations.

The settlement and delivery date are to be on the second day after the trading date (T+2). Delivery versus Payment (DVP) and Receipt versus Payment (SVP) are implemented on a Real Time Gross Settlement (RTGS) basis.

For the clearing and settlement system, Thailand has adopted a Real Time Gross Settlement (RTGS) basis which Delivery versus Payment (DVP) and Receipt versus Payment (SVP) are implemented.

The settlement and delivery date are to be on the second day after the trading date (T+2). The procedures’ details are as follows:

1. Seller and buyer send information regarding delivery and receipt of securities together with payment for each transaction either via TSD Web Service or SWIFT Network.
2. TSD verifies the information before matching. If the securities balance of the seller in the depository system is sufficient, the system will proceed with TSD sending order to the BOT’s BAHTNET system to transfer funds to the buyer’s account. In case that the securities balance is not sufficient, the order will be held in the queue until end of the day.
3. The BAHTNET system will go through the balance of the buyer to ensure that there is sufficient amount of funds for transferring. In case of problem, the BOT will inform TSD immediately.

4. If there is sufficient amount of funds, the BAHTNET system will transfer the funds from the buyer’s account to the seller’s account and inform TSD of the transaction accordingly.

5. TSD sends confirmation to buyer and seller at the end of the day.

D. Business Process Flowchart Thailand Bond Market (OTC Market)/ DVP

1. Seller and Buyer trade via OTC market.
2. Seller and Buyer perform pre-matching process with counterparty manually via phone.
3. Seller and Buyer send the transaction details to TCH via PTI System.
4. TCH checks trade data from Seller and Buyer.
5. TCH sends matching results to Seller and Buyer via PTI System.( to be confirmed)
6. TCH checks availability of securities in member account.
7. TCH sends clearing results to Seller and Buyer via PTI System.( to be confirmed)
8. TCH sends settlement details to TSD and BOT. Actually TSD seems to get automatically the details because TSD is also connected to PTI System. (to be confirmed)
10. TSD sends settlement report to Seller and Buyer via PTI System.( to be confirmed)
11. BOT executes cash settlement.
12. BOT sends settlement report to Seller, Buyer and TCH.( to be confirmed)

E. Role of TCH

Thailand Clearing House Co., Ltd (TCH) will be responsible for the clearing of debentures traded in the Bond Electronic Exchange (BEX) under the supervision of the Stock Exchange of Thailand (SET).
As a clearinghouse for all securities and derivatives traded on the SET, BEX, Market for Alternative Investment (MAI) and Thailand Futures Exchange (TFEX), TCH’s most important role is to serve as the central counterparty to all trading activities on those exchanges.

Thus, TCH will guarantee clearing and settlement for a concerned party no matter if any counterparty breaks their commitment.

This is a crucial mechanism to lessen counterparty risk.

Immediately after a trading transaction is matched and those exchanges have been confirmed at the matching transactions by their members, the TCH, as the direct central counterparty, will become a buyer to every selling member and a seller to every buying member.

Therefore, a member who has bought or sold the securities has an obligation not to the party on the other side of the transaction, but to the clearinghouse, just as the clearinghouse has an obligation to the member. This is called a novation process.

F. Definition of clearing and settlement and assessment

“Securities clearing and settlement” means the payment, acceptance of payment, delivery, and taking delivery of, securities.


Extract from Table 1. Detailed Assessment of Observance of Thailand Securities Depositories (TSD) of the Committee of Payment and Settlement Systems (CPSS)-International Organization of Securities Commission (IOSCO) Recommendations for Securities Settlement Systems (RSSS)

From the FINANCIAL SECTOR ASSESSMENT PROGRAM THAILAND DETAILED ASSESSMENT OF OBSERVANCE THAILAND SECURITIES DEPOSITORY (TSD) OF THE CPSS/IOSCO RECOMMENDATIONS FOR SECURITIES SETTLEMENT SYSTEMS APRIL 2008 [IMF Country Report No.09/150 May 2009]

1. Legal basis of the clearing and settlement

The securities clearing and settlement activities in Thailand are governed and regulated by specifically issued laws and regulations and by provisions in other legislations and regulations. The main laws and regulations are:

a. The Civil and Commercial Code: (e.g., provisions governing juristic acts, obligations, contracts);
b. The Securities and Exchange Act B.E. 2535 (SEA) (Sections 50–55,199, 224–228);
c. The Public Limited Company Act B.E. 2535;
d. The notifications, rules, and regulations issued by the Stock Exchange of Thailand (SET), and the TSD;
e. The agreement between members and the TSD as a central securities depository (CSD) and a clearinghouse;
f. BAHTNET Rules and Regulations B.E. 2549; and
g. The Bankruptcy Act B.E. 2483.
2. Enforceability of transactions

The contractual arrangements between TSD and its participants are fully enforceable under the Civil and Commercial Code. In particular, each participant signs a contract with the TSD, which binds the participant to the TSD Regulations. TSD Regulations can be enforced through a legal action.

3. Customer assets protection

The law and regulation requires a clear segregation and application of the customers’ assets from those of the intermediaries. At the level of the CSD, an intermediary is obliged to separate between its securities holdings and customers’ holdings. TSD is also required to separate between its own securities holdings and the assets of its participants. In addition, entities acting as custodians such as banks, investment firms and other financial intermediaries are legally obliged to have an internal accounting system that allows the identification of the holdings of their customers at any time.

4. Immobilization and dematerialization of securities

In accordance with Sections 225 - 228 of the SEA, immobilization in the TSD system has been arranged through the transfer of securities by book-entry. The transfer of securities by book-entry shall be deemed to be the delivery of securities which constitutes the legal basis for the validity of securities transfer under Section 199 and Section 51 of the SEA. Moreover, securities transferred into the name of the TSD shall be presumed to be securities held by the TSD on behalf of its members or for any customers of its members.

However, there is no explicit legislation for the dematerialization of securities.

5. Netting arrangements

TSD assumes the role of central counterparty (CCP) for multilateral netting procedure that takes place before the settlement is executed. This netting arrangement is enforceable under Sections 341 - 348 of the Civil and Commercial Code and Section 102 of the Bankruptcy Act B.E. 2483. However, since Section 102 of the Bankruptcy Act allows netting of obligations only if the cause of indebtedness incurred before the date of the receivership order, the TSD may not net its obligations against the obligations of the insolvent participant which arise on that date.

6. Securities lending arrangements

Securities lending and collateralization arrangements are based on the outright transfer of securities. The SEC rule requires the transfer of the legal title in securities borrowed from the lender to the borrower, and the legal title in collateral is transferred from the borrower to the lender.
7. Finality of settlement

TSD rule clearly states the timing of finality and the way finality is achieved. The transfer of funds is enforced by the BOT regulation. Furthermore, there is no explicit legal protection for settlement finality. It can be challenged by a court decision. In accordance with Section 115 of the Bankruptcy Act, the court is empowered to reverse the debtor’s transfer of assets during the three months prior to an application to adjudicate him as bankrupt and thereafter if the court finds that the debtor transfers such assets with the intention to give undue preference to a creditor.

Thus, if the court orders the receivership of a clearing house member or a settlement bank, the court may cancel the transfer of funds and securities made during that period if the official receiver is able to prove that the transfer has been made by the debtor with the intention to cause other creditors a disadvantage.

8. Delivery versus payment (DVP)

TSD rule clearly states that all securities transactions must be settled on a DVP basis.

9. Challenges by a court

No court case has yet occurred.

10. Enforceability of rules and regulations in the event of a bankruptcy

There is no explicit legal protection of the netting procedures as well as the settlement finality when insolvency is involved. Consequently, it cannot be ruled out that transactions settled in TSD will be protected against a court decision in the event a participant becomes insolvent.

11. Cross-border participation

There is no cross-border participation in TSD.

12. Conflict of law issues

Not applicable.

Assessment (1-12): Broadly observed
Comments: For the observance of this recommendation, it is recommended to implement adequate legal measures that ensure the netting arrangement is legally protected even in the event of the insolvency of a participant.

G. Challenge / Future direction

1. The contractual arrangements between TSD and its participants are fully enforceable under the Civil and Commercial Code. Netting arrangements can be challenged in the event of bankruptcy.
   [From: Table 2. Summary Observance of TSD of the CPSS-IOSCO Recommendations for Securities Settlement Systems]

2. As a nice to have arrangement, explicit legislation for the dematerialization of securities may be considered.
VI. Cost and charging methods

A. Average issuing and trading costs for Corporate Bonds and CPs
   Collect on “Maintaining of Securities Depository Account Fee” basis

1. Transfer fee (CSD, Bank): calculate and collect on transaction basis

<table>
<thead>
<tr>
<th>Menu</th>
<th>Fee</th>
</tr>
</thead>
<tbody>
<tr>
<td>a. Transfer fee for all government bond transfers that are not a personal asset transfer, inheritance transfer, or any transfers according to court order or the transfer of securities between securities accounts of the same owner.</td>
<td>THB 35</td>
</tr>
<tr>
<td>b. Other securities transfer that are not categorized in (a)</td>
<td>THB 10</td>
</tr>
</tbody>
</table>

2. Registration/Conversion Fees

   TSD charges registration fee for THB 20 in conversion of local shares to foreign shares or vice versa.
   Asset Management Companies charge registration fee for THB 10 per application for open-ended unit trusts for registration of name change.

3. Underwriting fee

   Depend upon the negotiation.

4. Brokerage Fees

   Securities Brokers (SET’s members) shall charge brokerage or commission fees on buying or selling of securities at the following rate plus 7% of VAT.

   a. For shares, warrants on shares, Transferable Subscription Right (TSR), Derivative Warrants (DW), Non-Voting Depositary Receipts (NVDR), or unit trust for Thai Trust Fund (TTF):

      | Trading Types             | Brokerage / Commission Fee (% of trading value) |
      |----------------------------|-----------------------------------------------|
      | Internet Trading           | 0.15%                                         |
      | Non-Internet Trading       | 0.25%                                         |

   b. For unit trusts, or warrants on unit trusts, at the rate of not less than 0.10% of trading value.

   c. For unit trusts of a fixed income fund, warrants on such unit trusts, or debt instruments, is negotiable.

   d. As part of the Stock Exchange of Thailand (SET)’s plan to fully liberalize of securities businesses in Thailand in 2012, starting from January 1, 2010, the new brokerage fee will be applied as details shown below and starting from January 1, 2012, the brokerage fee will be freely negotiable.

B. Average on-going costs for Corporate Bonds and CPs

1. Maintenance fee at CSD:

   TSD collects from the value of the remaining securities in the depository account monthly. Since TSD do not allow individual investor to open the depository account with TSD and recognize the investor individually, TSD charge the fee to the participant...
members who open depository accounts for their clients directly. The fees are shown as in the following.

**Table of Maintaining of Securities Depository Account Fee**

<table>
<thead>
<tr>
<th>Menu</th>
<th>Fee per THB 1 million of Value of Investment</th>
<th>the securities depository period by calculating the outstanding value of securities</th>
</tr>
</thead>
<tbody>
<tr>
<td>a. Debentures /Convertible debentures, Short-term bonds, Warrants, and other similar securities</td>
<td>THB 1.00 monthly</td>
<td>Par Value</td>
</tr>
<tr>
<td>b. Bond, Treasury bills or other types of government debt instruments in depository account. - For 100% tax-exempted foundations and financial institutions whose government bonds are legal liquidity reserve</td>
<td>THB 0.25 monthly</td>
<td>Par Value</td>
</tr>
</tbody>
</table>

2. Interest payment / redemption fee at CSD:

a. Interest Payment: CSD collects the fee of compilation of the bondholders' list on Record Date at the rate of THB 5 per transaction, with a minimum fee of 500 baht per security.

b. Redemption Fee: CSD collects the fee of compilation of the bondholders' list on Record Date at the rate of THB 5 per transaction, with a minimum fee of 500 baht per security. Besides, CSD collects the withdrawal fee from CSD’s members for withdrawing and terminating the securities from Book Entry System at the rate THB 65 per one depository account.

See the details about registration/transfer/registrar fee, deposit, withdrawal in the web link as follows.

http://www.tsd.co.th/en/info/fee1.html#Deposit
VI. Market size / statistics

A. Nature and Size of Bond market

1. The size of the market for debt instruments in terms of nominal or notional principal amounts outstanding and gross market values traded (for 2009).

<table>
<thead>
<tr>
<th>Debt Instruments</th>
<th>Nominal/Notional Amount Outstanding (In millions of US Dollars)</th>
<th>Gross Market Value Traded per annum (In millions of US Dollars)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>OTC</td>
<td>Exchange</td>
</tr>
<tr>
<td>Bonds</td>
<td>176,564.49</td>
<td>447,416.87</td>
</tr>
<tr>
<td>Government bonds</td>
<td>144,287.10</td>
<td>442,249.60</td>
</tr>
<tr>
<td>Corporate bonds</td>
<td>32,277.39</td>
<td>5,167.27</td>
</tr>
<tr>
<td>Commercial papers</td>
<td>2,298.00</td>
<td>1,512.11</td>
</tr>
</tbody>
</table>

2. The data for corporate bonds issues by type of issue.

<table>
<thead>
<tr>
<th>Sector</th>
<th>2005</th>
<th>2006</th>
<th>2007</th>
<th>2008</th>
<th>2009</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>No of Issues</td>
<td>Amount</td>
<td>No of Issues</td>
<td>Amount</td>
<td>No of Issues</td>
</tr>
<tr>
<td>Public Issues</td>
<td>67</td>
<td>37,168</td>
<td>84</td>
<td>39,558</td>
<td>71</td>
</tr>
<tr>
<td>Private Placements</td>
<td>31</td>
<td>4,279</td>
<td>12</td>
<td>5,093</td>
<td>12</td>
</tr>
</tbody>
</table>

3. Total corporate bond trades in the secondary market shown in the table below.

<table>
<thead>
<tr>
<th>Year</th>
<th>Exchange Traded</th>
<th>OTC Trades</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>No of Trades*</td>
<td>Traded Value USD million</td>
</tr>
<tr>
<td>2005</td>
<td>N/A</td>
<td>N/A</td>
</tr>
<tr>
<td>2006</td>
<td>8,535</td>
<td>8</td>
</tr>
<tr>
<td>2007</td>
<td>8,849</td>
<td>9</td>
</tr>
<tr>
<td>2008</td>
<td>6,828</td>
<td>7</td>
</tr>
<tr>
<td>2009</td>
<td>4,585</td>
<td>5</td>
</tr>
</tbody>
</table>

4. Size of the market for each type of bonds (for 2009).

<table>
<thead>
<tr>
<th>Type of Bond</th>
<th>Amount (US Dollar in Millions)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Public Issue</td>
</tr>
<tr>
<td>Plain Vanilla Bond*</td>
<td>11,713.97</td>
</tr>
<tr>
<td>Floating Rate Bond</td>
<td>61.54</td>
</tr>
<tr>
<td>Fixed Rate Bond</td>
<td>11,652.43</td>
</tr>
<tr>
<td>Structured Bond</td>
<td>62.37</td>
</tr>
<tr>
<td>Convertible Bond</td>
<td>N/A</td>
</tr>
<tr>
<td>Other Types of Bonds</td>
<td>N/A</td>
</tr>
</tbody>
</table>

* Plain vanilla bond = floating rate bond + fixed rate bond

5. The main buyers of corporate bond markets (for 2009).

<table>
<thead>
<tr>
<th>Entity</th>
<th>%</th>
</tr>
</thead>
<tbody>
<tr>
<td>Mutual Funds</td>
<td>7.9%</td>
</tr>
<tr>
<td>Banks/FIs</td>
<td>6.2%</td>
</tr>
<tr>
<td>Corporate Entities</td>
<td>6.4%</td>
</tr>
</tbody>
</table>
Insurance Companies 8.6%
Pension Funds* 14.8%
Retail Investors 44.7%
Others—Please specify Government sector, foundation, co-operatives, temples, etc. 11.4%

6. Market size from the following point of view (by Local Currency)

The information will be sent to you later. (SEC) (?)

### TABLE 2: SIZE OF THAILAND FINANCIAL MARKET

<table>
<thead>
<tr>
<th>Economic Indicator</th>
<th>2002</th>
<th>2003</th>
<th>2004</th>
<th>2005</th>
<th>2006</th>
<th>2007</th>
<th>2008</th>
<th>2009</th>
<th>2010</th>
</tr>
</thead>
<tbody>
<tr>
<td>Bank Loans (Billion * )</td>
<td>4,602.70</td>
<td>4,701.50</td>
<td>5,081.35</td>
<td>5,488.45</td>
<td>5,706.75</td>
<td>6,221.76</td>
<td>7,368.65</td>
<td>7,675.57</td>
<td>8,767.65</td>
</tr>
<tr>
<td>Equities (SET mcl. cap) (Billion ** )</td>
<td>1,086.24</td>
<td>4,798.86</td>
<td>4,521.80</td>
<td>5,105.11</td>
<td>5,078.70</td>
<td>6,696.07</td>
<td>5,856.21</td>
<td>5,877.10</td>
<td>8,134.68</td>
</tr>
<tr>
<td>Domestic Bond (let par) (Billion *** )</td>
<td>2,000.00</td>
<td>2,518.00</td>
<td>2,740.38</td>
<td>3,566.84</td>
<td>4,085.26</td>
<td>4,885.37</td>
<td>5,800.05</td>
<td>6,114.49</td>
<td>6,879.46</td>
</tr>
</tbody>
</table>

Source: * Bank of Thailand
** SET
*** The BMA

http://www.set.or.th/thailandmarket_statistics.html
Monthly Report >> Thai Bond Summary >> Part 1 (include non-registered bonds)

### TABLE 6: THAILAND OUTRIGHT TRADING AND OUTSTANDING VALUE BETWEEN 2009 & 2010 (THB Min)

<table>
<thead>
<tr>
<th>Type</th>
<th>2009</th>
<th>2010</th>
<th>% Change</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Outright Trading</td>
<td>Outstanding</td>
<td>Outright Trading</td>
</tr>
<tr>
<td>Govt Bond</td>
<td>1,484,396.55</td>
<td>1,130,820.44</td>
<td>1,754,405.00</td>
</tr>
<tr>
<td>State Own Enterprise</td>
<td>78,988.51</td>
<td>352,092.97</td>
<td>45,230.05</td>
</tr>
<tr>
<td>- Guaranteed</td>
<td>59,435.16</td>
<td>372,818.27</td>
<td>35,099.19</td>
</tr>
<tr>
<td>- Non-guaranteed</td>
<td>19,553.35</td>
<td>159,274.70</td>
<td>8,133.88</td>
</tr>
<tr>
<td>T-Bills</td>
<td>1,285,810.91</td>
<td>2,989,340.66</td>
<td>807,057.49</td>
</tr>
<tr>
<td>State Agency</td>
<td>11,520,110.58</td>
<td>2,819,557.66</td>
<td>13,615,924.92</td>
</tr>
<tr>
<td>Corporate</td>
<td>107,017.46</td>
<td>1,112,636.02</td>
<td>178,104.15</td>
</tr>
<tr>
<td>- Long-term</td>
<td>103,496.40</td>
<td>1,048,956.97</td>
<td>127,568.91</td>
</tr>
<tr>
<td>- Short-term (Commercial Paper)</td>
<td>3,520.86</td>
<td>74,681.05</td>
<td>50,599.20</td>
</tr>
<tr>
<td>Total Bond</td>
<td>1,454,718.30</td>
<td>6,086,733.70</td>
<td>16,607,888.58</td>
</tr>
<tr>
<td>- Monthly Average</td>
<td>1,212,060.73</td>
<td>1,388,971.04</td>
<td>1%</td>
</tr>
<tr>
<td>- No. of trading days</td>
<td>249</td>
<td>248</td>
<td>4%</td>
</tr>
<tr>
<td>- Daily Average</td>
<td>59,842.85</td>
<td>68,634.85</td>
<td>13,791.85</td>
</tr>
<tr>
<td>No. of Outright Transaction</td>
<td>94,977</td>
<td>104,533</td>
<td>10%</td>
</tr>
<tr>
<td>- Monthly Average</td>
<td>7,912</td>
<td>8,771</td>
<td>11%</td>
</tr>
<tr>
<td>- Daily Average</td>
<td>597</td>
<td>541</td>
<td>11%</td>
</tr>
<tr>
<td>Dealer Participation</td>
<td>39</td>
<td>39</td>
<td>0%</td>
</tr>
</tbody>
</table>

Source: ThaiBMA

B. Size of LCY Bond Market in USD

http://asianbondsonline.adb.org/thailand/data/bondmarket.php?code=LCY in USD Local

<table>
<thead>
<tr>
<th>Date</th>
<th>Govt (in USD Billions)</th>
<th>Corp (in USD Billions)</th>
<th>Total (in USD Billions)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Mar-95</td>
<td>10.44</td>
<td>0.69</td>
<td>11.13</td>
</tr>
<tr>
<td>Jun-95</td>
<td>10.61</td>
<td>0.65</td>
<td>11.26</td>
</tr>
<tr>
<td>Sep-95</td>
<td>10.99</td>
<td>0.57</td>
<td>11.56</td>
</tr>
<tr>
<td>Dec-95</td>
<td>11.54</td>
<td>0.85</td>
<td>12.39</td>
</tr>
<tr>
<td>Mar-96</td>
<td>11.64</td>
<td>4.80</td>
<td>16.44</td>
</tr>
<tr>
<td>Jun-96</td>
<td>12.11</td>
<td>4.72</td>
<td>16.83</td>
</tr>
<tr>
<td>Sep-96</td>
<td>12.12</td>
<td>5.8</td>
<td>17.92</td>
</tr>
<tr>
<td>Dec-96</td>
<td>13.14</td>
<td>5.82</td>
<td>18.95</td>
</tr>
<tr>
<td>Month</td>
<td>Value1</td>
<td>Value2</td>
<td>Value3</td>
</tr>
<tr>
<td>--------</td>
<td>--------</td>
<td>--------</td>
<td>--------</td>
</tr>
<tr>
<td>Mar-97</td>
<td>15.51</td>
<td>5.49</td>
<td>20.99</td>
</tr>
<tr>
<td>Jun-97</td>
<td>15.92</td>
<td>5.81</td>
<td>21.72</td>
</tr>
<tr>
<td>Sep-97</td>
<td>9.80</td>
<td>3.88</td>
<td>13.68</td>
</tr>
<tr>
<td>Dec-97</td>
<td>7.64</td>
<td>3.01</td>
<td>10.65</td>
</tr>
<tr>
<td>Mar-98</td>
<td>9.98</td>
<td>3.45</td>
<td>13.44</td>
</tr>
<tr>
<td>Jun-98</td>
<td>13.46</td>
<td>2.94</td>
<td>16.40</td>
</tr>
<tr>
<td>Sep-98</td>
<td>14.86</td>
<td>3.18</td>
<td>18.04</td>
</tr>
<tr>
<td>Dec-98</td>
<td>20.33</td>
<td>4.12</td>
<td>24.45</td>
</tr>
<tr>
<td>Mar-99</td>
<td>23.28</td>
<td>3.94</td>
<td>27.21</td>
</tr>
<tr>
<td>Jun-99</td>
<td>24.74</td>
<td>4.17</td>
<td>28.91</td>
</tr>
<tr>
<td>Sep-99</td>
<td>23.42</td>
<td>3.95</td>
<td>27.37</td>
</tr>
<tr>
<td>Dec-99</td>
<td>26.57</td>
<td>4.96</td>
<td>31.53</td>
</tr>
<tr>
<td>Mar-00</td>
<td>26.51</td>
<td>5.14</td>
<td>31.65</td>
</tr>
<tr>
<td>Jun-00</td>
<td>26.53</td>
<td>5.23</td>
<td>31.76</td>
</tr>
<tr>
<td>Sep-00</td>
<td>26.64</td>
<td>5.07</td>
<td>31.72</td>
</tr>
<tr>
<td>Dec-00</td>
<td>25.89</td>
<td>5.16</td>
<td>31.05</td>
</tr>
<tr>
<td>Mar-01</td>
<td>26.64</td>
<td>4.78</td>
<td>31.42</td>
</tr>
<tr>
<td>Jun-01</td>
<td>27.19</td>
<td>5.21</td>
<td>32.4</td>
</tr>
<tr>
<td>Sep-01</td>
<td>29.14</td>
<td>5.64</td>
<td>34.78</td>
</tr>
<tr>
<td>Dec-01</td>
<td>30.12</td>
<td>5.69</td>
<td>35.81</td>
</tr>
<tr>
<td>Mar-02</td>
<td>32.04</td>
<td>5.56</td>
<td>37.60</td>
</tr>
<tr>
<td>Jun-02</td>
<td>33.92</td>
<td>6.12</td>
<td>40.04</td>
</tr>
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VII. Presence of an Islamic Finance (Islamic bond (Sukuk)) market

A. The current development of Islamic bond market in Thailand

Thailand is at the early stage of developing Islamic bond market. The specific regulations for issuance and offering of Sukuk have just been announced in early January 2011. The regulatory framework is under the SEC Act and Trust for Transactions in capital market Act.

B. Regulations for plain vanilla Sukuk

Now Thailand has just launched regulations for plain vanilla Sukuk (Thai issuer only). Regulations for issuance plain vanilla Sukuk are in-line with regulations for issuance bond (approval criteria, filing criteria, credit rating requirement, and taxed issue). However, Sukuk does not have shelf registration regime. Issuers have to get approval from SEC for every new issue.

C. Specific regulation for Sukuk

In addition, Shariah advisor has to certify whether Sukuk structure is Shariah compliance. Financial advisor has to certify the qualification of Shariah advisor. And legal advisor has to certify that trust deed shall be enforceable under Thai law.

D. Infrastructure for Sukuk

Sukuk mostly has the same infrastructure as bond for example the trading venue which can be OTC market or BEX.
IX. History of Debt Market development

Under the Capital Market Development Committee, bond market development measures can be summarized as follows:

1. To develop the government’s cash management methods and study

Alternatives of amending laws relating to treasury reserve, so that the government can issue treasury bills efficiently. Also, this will help decrease the cost of funds that the government faces.

2. The Rural Decentralization Act

The Rural Decentralization Act has empowered local administrative body to raise fund from the bond market for development of public utilities. However, in practice, only large urban administrative bodies such as the Bangkok Metropolis, Chiangmai, Phuket, etc., are capable of doing so. These administrative bodies may issue Revenue Bonds and redeem the capital investment plus interest to investors with income from public utilities.

3. Development of private repo and Security Borrowing and Lending (SBL)

One way to improve liquidity of bond instrument is the promotion of private repo and Security Borrowing and Lending (SBL).

The Bank of Thailand shall take lead in promoting these transactions provided by institutional investors who heavily invest in bond, yet with very few exchanges, such as funds and insurance companies etc.

So these bonds will be used as a tool for monetary policy through bilateral repo with primary dealers (PDs) of the BOT.

These PDs are able to carry forward this transaction through exchange or private repo. In the future, there will be expansion of private repo base as to cover non-banking institutions, private enterprises and foreign investors.

This strengthens secondary market by injecting more liquidity and activities in the private repo market.
X. Next Step → Future Direction


The Government launched Thailand’s first Capital Market Master Plan in early 2002 in an effort to develop and diversify the country’s sources of funds. The plan outlined broad initiatives that are considered the main policy framework guiding Thai capital market development. These initiatives include promoting good governance, enlarging the investor base, increasing the quantity and variety of financial instruments, enhancing infrastructure, and reforming the supervisory system.


http://www.bot.or.th/Thai/FinancialInstitutions/Highlights/MasterPlan/Documents/FSMP.pdf

The second phase of the plan was released in February 2006 covering the period 2006 - 2010. It was proposed by the Federation of Thai Capital Market Organizations (FeTCO) and related government bodies to the Thai Ministry of Finance.

The Federation of Thai Capital Market Organizations (FeTCO) and related government bodies proposed the second phase of master plan (2006 – 2010) to the Ministry of Finance. The proposed plan emphasizes principal measures to develop and strengthen the Thai capital market to be ready for changes in the global markets.

Also, it’ll be a stabler market that will support the growth of the economy in a more sustainable manner.

Thailand’s Minister of Finance, Dr. Thanong Bidaya, chaired the workshop brainstorming the Thai Capital Market Master Plan II held Feb. 1 2006 that the plan was jointly proposed by The Federation of Thai Capital Market Organizations (FeTCO) as well as other relevant market bodies.

“The government still emphasizes the continued development of the Thai capital market to be in line with international standards. The Thai Capital Market Master Plan II will be for the 5-year period from 2006 – 2010. It will essentially make the Thai capital market an efficient channel for fundraising as well as a good savings choice. It will not only help increase the overall market capitalization, but will also improve price stability,” Dr. Thanong said.

The 7 principal measures include the equity, bond, and derivatives markets. Also, it involves listed companies, intermediaries, investors, as well as the supervisory bodies.

The goals of this second phase plan includes increasing the proportion of institutional investors from the current 10% of total turnover to 20%, working with the SET100 companies to adjust their price-earnings (P/E) ratios so that their P/E better reflects their actual value, working with the SET100 as well as other large-scale companies whose major shareholders are the public sector, and raising the standards of listed companies by offering incentives and privileges.

As for the bond market, it will be continue to be promoted to encourage its growth to enable it to attain the same volume as the money market. Greater participation by retail investors will also be encouraged.
More market product innovations such as derivatives instruments and securitization will be introduced. These new innovations will help reduce the risks of both the entrepreneurs and investors.

To help strengthen the intermediary institutions, their capabilities will be improved so that they become better versed in offering integrated products and have a more suitable capital base prior to opening up for foreign competition.

The liberalization of trading fees will also be undertaken on a step-by-step basis, provided that the types and sizes of transactions are carefully considered.

The business operators will therefore have sufficient lead time to prepare or adjust to the liberalization.

With regards to the raising of the standards of corporate governance, there will be incentives and education schemes to help push forward this effort. It is targeted that the education outreach efforts will cover every academic institution in the country by 2010.

The Securities and Exchange Commission (SEC) and The Stock Exchange of Thailand (SET) will be developing as well as supervising the capital market. Adjustments of rules or regulations to further improve the market's accessibility and make it more in line with the current trends, products and technologies will be considered.

Chairman of FeTCO, Dr. Kongkiat Opaswongkarn, said that all relevant parties in the capital market including all the listed companies, the securities companies, and the investment management companies, are playing important roles in pushing for the plan to materialized within this more competitive environment brought on by greater liberalization in the financial service sector.

SET President Mr. Kittiratt Na-Ranong, who is also the secretary of FeTCO presented the master plan in this workshop. Mr. Kittiratt said that the second master plan helps formulate the direction, goals, key measures, responsible persons & organizations, and the time frame for the further development of the market. Each of the principal measures will be undertaken by a key organization so that the Plan’s goals can be achieved. This master plan will be implemented beginning this year on through 2010.

“It is the SET’s important mission to coordinate with all relevant parties to push for the success of this plan. We are confident that the plan, which has both qualitative and quantitative goals, will eventually bear fruit for the Thai capital market and the Thai economy as a whole,” Mr. Kittiratt said.

C. Capital Market Master Plan (2009)
http://www2.mof.go.th/press_releases_detail.php?id=21

4 November, 2009, the Economic Cabinet has approved the Capital Market Masterplan as proposed by the Capital Market Development Committee which is chaired by the Minister of Finance.

The capital market is important to a country’s economic and social system. It plays the crucial roles of capital raising for both public and private sectors, promoting balance and
stability in the financial system, decreasing dependency on the banking sector, driving the economy forward and creating jobs, as well as being an alternative method for savings. A strong capital market will lessen the impact of economic fluctuations which can be compounded by the fast-flowing nature of capital.

However, there are still many issues besetting the Thai capital market: few institutional investors, small retail investor base, limited financial products, high transaction costs, and lack of efficient regulatory enforcement are some examples.

Moreover, Thailand’s capital markets in recent times have grown at a very slow pace. The size of the stock market compared to GDP is only 51% (as of June 2009) which is smaller than other countries in the region such as Hong Kong (845%), Singapore (202%), Malaysia (104%) and South Korea (66%).

Should this trend continue, Thailand’s capital market will stagnate and become increasingly marginalized.

Various studies have shown that inadequate development of the capital markets will impact its ability to raise, channel and monitor resources efficiently. In the end, this will lead to loss of growth opportunities, standard of living and prosperity.

In recognizing the importance of the capital market, Prime Minister Abhisit Vejjajiva has appointed the Capital Market Development Committee (The Committee) on January 27, 2009.

This appointment is a continuation from the last but one government which has appointed the first Committee on March 25, 2008.

The Committee is tasked with formulating an overall masterplan for the development of Thai capital market as well as monitoring the implementation of such plan.

The Committee comprises of the Minister of Finance as the chairperson and experts from public and private sectors.

In formulating the Capital Market Development Masterplan (The Masterplan), the Committee has solicited inputs and opinions from all stakeholders and has formed the vision and the 5-year development objectives (2009-2013) as follow:

The Thai capital market is the primary mechanism for aggregating, channeling, and monitoring economic resources.

The goal of the capital market is to perform these tasks efficiently to increase overall competitiveness of Thailand.

The Committee has formulated 6 primary missions and objectives to realize this vision:

1. Capital market must be easily accessible by investors seeking investment opportunities and corporations seeking funds
2. Increase quality and variety of products and services
3. Reduce cost of funds to issuers and any intermediary and transaction costs to investors to enable Thai companies to become more competitive
4. Develop efficient infrastructure framework in legal, regulations, accounting, tax, information, technology and enforcement
5. Educate investors and ensure that adequate protection mechanism are in place
6. **Promote competition** in the Thai capital market and build links with the global market system.

The Masterplan consists of 8 important reform measures that will affect the course of development and bring about major changes in the system.

1. **Measure 1: Abolish the Monopoly and Improve Competitiveness of the Stock Exchange of Thailand (SET).**

   Liberalization of capital flows and competitive pressure increase the chances of the SET being marginalized.

   To make the SET responsive to fast-changing business environments, its business structure must be transformed to increase efficiency and promote competitiveness. First step is to demutualize the SET, convert it into a public company (The Exchange Company), separate the exchange business from capital market development work, and **establish a Capital Market Development Fund (CMDF)** with the mission of long-term capital market development.

   The SET’s monopoly on exchange businesses will also end. Therefore, there may be other trading platforms permitted to trade listed stocks. The Exchange Company will be allowed to permit persons other than securities firms incorporated in Thailand to have direct access if it wishes to in order to increase liquidity and expand investment base to promote linkage with global capital market, and decrease limitations which currently obstruct the growth of Thai capital market.

2. **Measure 2: Liberalization of securities business to promote market efficiency.**

   This measure, while in line with recent trends of liberalization in the financial system, also aims to increase competitiveness of Thai capital market and enable it to withstand impact of fast capital flow.

   Liberalization of licenses will foster the market competition. Securities firms will have to adjust by forming alliances with strategic partners to increase its efficiency by offering new products and the long run.

3. **Measure 3: Reforming Legal Framework.**

   Currently, there are draft laws relating to the capital market, being proposed to the House of Representatives which are:

   (1) Amendment Act to Royal Enactment on Special Purpose Juristic Persons for Securitisation B.E.....

   (2) The Draft of Commercial Collateral Act B.E and

   (3) Amendment Act to the Civil and Commercial Code B.E..... The government should keep pushing for passage of these laws.

   The Committee also had the resolution to propose further reforms, including

   (1) Laws to facilitate mergers and acquisitions activities,

   (2) Adopt civil penalty and

   (3) Amend the Civil Procedure Code to include class action lawsuits, which would help make enforcement of the Securities and Exchange Act more efficient.

4. **Measure 4: Streamline Tax System.**

   This measure aims to make the tax system more efficient to transactions, improve fairness, and provide tax incentives for transactions that the state would like to promote for the development of capital market.

   Taxation areas to streamline include those related to mergers and acquisitions, investments in debentures, elimination of double taxation on dividends, equalize tax incentives on direct investment and investment through intermediaries, transfer of investments in provident funds, public savings funds, life insurance premiums, Islamic bonds, securities borrowing and lending of the Bank of Thailand, and venture capital.
5. **Measure 5: Develop Financial Products.**
   Currently, the Thai capital market has few financial products to choose from, which cannot take care of diverse needs of investors thus making the market relatively unattractive. This measure aims to push for development of new products which would help increase the variety of instruments and consequently help develop the market. Example of new products are Infrastructure Fund to promote investments by the private sector, life annuities, interest rate derivatives, inflation-indexed government bonds, Islamic bond, venture capital, and divestiture of ministry of finance’s shares of publicly traded companies.

6. **Measure 6: Establishment of a National Savings Fund.**
   The Ministry of Finance had proposed a National Savings Fund Act, and the cabinet in a meeting on October 20, 2009 has agreed to the first draft. The National Savings Fund will cover workers outside the formal system comprising approximately 70% to total labor force in Thailand. The objective is to institutionalize savings for retirement, create equality of opportunity, and ensure that these informal sector workers are provided with some income after retirement. The National Savings Fund will become a major source of savings and investments in Thailand and will contribute to the development of Thai capital markets. It will help lessen the volatility of capital movements and also indirectly promote new financial products as well.

7. **Measure 7: Developing a Culture of Savings and Investments.**
   This measure aims to provide choices when investing in provident fund and Government Pension Fund, so that investors’ needs are met. It will also encourage investors to be proactive about acquiring new knowledge on financial products, so that investors can truly determine what types of products suit them.

8. **Measure 8: Development of Domestic Bond Market.**
   This measure aims to develop the government’s cash management methods and study alternatives of amending laws relating to treasury reserves, so that the government can issue treasury bills efficiently. The government should also be able to manage treasury reserves for yield by such means as depositing the reserves with other institutions instead of the Bank of Thailand. This will help decrease the cost of funds that the government faces. Moreover, the Bank of Thailand will take the lead in developing and promoting the private repo and securities borrowing and lending markets, providing the bond market with another tool to manage liquidity efficiently with low risks. Overall, this would lead to further growth in the market.

Aside from the 8 reform measures, the Masterplan consists of 34 further measures that should be implemented. These measures are important in changing the basic framework and developing new infrastructures in the long run, which would lead to the fulfillment of the Masterplan’s main objectives.

After the Masterplan has been approved, the drafting subcommittee will transform into the Implementation and Oversight Committee and charged with overseeing, monitoring, and
assessing the implementation of the Masterplan. The new committee will use KPIs to assess progress and efficiency of the implementation.

The Committee believes that success in implementing the Masterplan, aside from directly benefiting the capital market, will have far-ranging benefits to society and economy as a whole. It will improve competitiveness, promote savings and retirement planning, improve linkage between Thai and global capital markets, and benefit all sectors of society. The results will be reflected and noticeable in the capital market structure itself.

Thai capital market will grow larger with more liquidity which will strengthen balance and stability of the financial market. It will become a key driver in economic development, which will be observable in the prosperity of Thai people in the long run.

D. Future Direction

In December 2010, the BOT signed an agreement with the Securities and Exchange Commission (SEC), Stock Exchange of Thailand (SET), Thai Bond Market Association, and PDMO to create the Thailand Financial Instruments Information Center (TFIIC).

TFIIC is part of the Thai government’s 5-year capital market master plan, which aims to collect information on financial instruments by related sources, share the information, and provide linkages among related agencies.

E. G-30 Compliance

<table>
<thead>
<tr>
<th>G-30 Compliance Recommendation</th>
<th>Implemented</th>
</tr>
</thead>
<tbody>
<tr>
<td>1 Eliminate paper and automate communication, data capture, and enrichment</td>
<td>Yes</td>
</tr>
<tr>
<td>2 Harmonise messaging standards and communication protocols</td>
<td>Yes</td>
</tr>
<tr>
<td>3 Develop and implement reference data standards</td>
<td>Yes</td>
</tr>
<tr>
<td>4 Synchronise timing between different clearing and settlement systems and associated payment and foreign exchange systems</td>
<td>Yes</td>
</tr>
<tr>
<td>5 Automate and standardise institutional trade matching</td>
<td>Yes</td>
</tr>
<tr>
<td>6 Expand the use of central counterparties</td>
<td>Yes</td>
</tr>
<tr>
<td>7 Permit securities lending and borrowing to expedite settlement</td>
<td>Yes</td>
</tr>
<tr>
<td>8 Automate and standardise asset servicing processes, including corporate actions, tax relief arrangements, and restrictions on foreign ownership</td>
<td>Yes</td>
</tr>
<tr>
<td>9 Ensure the financial integrity of providers of clearing and settlement services</td>
<td>Yes</td>
</tr>
<tr>
<td>10 Reinforce the risk management practices of users of clearing and settlement service providers</td>
<td>Yes</td>
</tr>
<tr>
<td>11 Ensure final, Simultaneous transfer and availability of assets</td>
<td>Yes</td>
</tr>
<tr>
<td>12 Ensure effective business continuity and disaster recovery planning</td>
<td>Yes</td>
</tr>
<tr>
<td>13 Address the possibility of failure of a systematically important institution</td>
<td>Yes</td>
</tr>
<tr>
<td>14 Strengthen assessment of the enforceability of contracts</td>
<td>Yes</td>
</tr>
<tr>
<td>15 Advance legal certainty over rights to securities, cash, or collateral</td>
<td>Yes</td>
</tr>
<tr>
<td>16 Recognise and support improved valuation methodologies and</td>
<td>Yes</td>
</tr>
</tbody>
</table>

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6 The G30 recommendations are taken from the Group of Thirty’s report Global Clearing and Settlement – A plan of action (Copyright © 2003 Group of Thirty) [http://www.partad.ru/wrld/word/g30app1.pdf](http://www.partad.ru/wrld/word/g30app1.pdf)
<table>
<thead>
<tr>
<th>Potential barrier area</th>
<th>Current situation</th>
<th>Market Assessment Questionnaire scores</th>
<th>Overall barrier assessment</th>
</tr>
</thead>
<tbody>
<tr>
<td>Quotas</td>
<td>There are no restrictions on foreign investment in local bonds.</td>
<td>OK</td>
<td>OK</td>
</tr>
<tr>
<td>Investor registration</td>
<td>There is no requirement for foreign investor registration. However, the documentation required for custodian account opening in Thailand needs to be notarised and consularised. Account-opening is a costly and time-consuming process. These documents are also required by the registrar agents for bond re-registration, and for some corporate events. Documents must be updated every year. This is strictly speaking not an investor registration issue.</td>
<td>OK</td>
<td>OK</td>
</tr>
<tr>
<td>FX controls - conversion</td>
<td>FX must be linked to securities trades. Each FX (or non-FX related payment transaction) equal to or greater than USD 20,000 must be reported by the sub-custodian to the Bank of Thailand (BoT), stating the purpose of the transaction. Foreign investors may net security transactions against a single foreign exchange, provided that all the settlement dates are the same. Same-day, next day and forward value FX are permitted if there is an underlying transaction. If there is no underlying transaction, then for buying THB from a commercial bank, FX is permitted up to THB 300 million across accounts per entity group, and for selling THB to commercial banks FX is permitted up to THB 10 million across accounts per entity group. Spot FX is permitted with no underlying transaction. Third party FX trades with resident financial institutions require proof of relevant underlying investment activity. However, while third party FX is permitted, it may not be supported by custodians. Investors commented that currency controls are a problem and that FX is difficult.</td>
<td>LOW</td>
<td>LOW</td>
</tr>
<tr>
<td>FX controls - repatriation of funds</td>
<td>As noted above, FX must be supported by an underlying securities transaction. Otherwise, for selling THB to commercial banks, FX is permitted up to THB 10 million across accounts per entity group.</td>
<td>LOW</td>
<td>LOW</td>
</tr>
<tr>
<td>Cash controls - credit balances</td>
<td>Many banks or investors must have two types of accounts (NRBS and NRBA), therefore there is more reporting and control. Funds must be managed separately and cannot be transferred across account type. Cash balances held by foreign investors are capped at THB300 million (c USD 9 million) across all accounts for the same account type (NRBA and NRBS) per custodian bank. The BoT may force non-resident investors to sell THB in excess of this limit to the BoT at the penalty rate. Many investors mentioned Thailand as a problem in this area.</td>
<td>HIGH</td>
<td>HIGH</td>
</tr>
<tr>
<td>Cash controls - overdrafts</td>
<td>Overdraft facilities provided by Thai financial institutions to foreign investors are capped at THB300 million (c USD 9 million) per group of non-residents per custodian bank. The BoT must approve the use of overdraft facilities and an investor’s use of a facility must be based on extenuating circumstances such as clerical errors. Foreign investors are not permitted to overdraft their THB cash accounts for the purpose of funding securities settlement. Custodian banks can request for 1 day long balance on behalf of non-resident investor if there is an evidence of next day trade or it is a US public holiday, etc. The monitoring is manual and difficult to control operationally and as a result, commonly not offered to the investors. Several investors mentioned Thailand as a problem in this area.</td>
<td>LOW</td>
<td>LOW</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
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</thead>
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<tr>
<td>Taxes</td>
<td>All non-resident investors are exempted from withholding tax on interest and capital gains tax from government and government agency bonds. Corporate bond interest (including state enterprise bonds) is taxed at 15%, withheld at source. The tax may be exempted or reduced by tax treaties.</td>
<td>LOW</td>
<td>LOW</td>
</tr>
<tr>
<td>Omnibus accounts</td>
<td>Omnibus accounts are allowed.</td>
<td>OK</td>
<td>OK</td>
</tr>
<tr>
<td>Settlement cycle</td>
<td>The settlement cycle for bonds is T+2 (or by agreement)</td>
<td>OK</td>
<td>OK</td>
</tr>
<tr>
<td>Message formats</td>
<td>The Thailand Securities Depository (TSD) uses SWIFT format for settlement messages but not for corporate event messages. Local market participants in general do not use SWIFT, apart from custodians.</td>
<td>LOW</td>
<td>LOW</td>
</tr>
<tr>
<td>Securities numbering</td>
<td>ISIN are available for all local bond issues, and are available on issue date. SWIFT and ISIN codes are used among banks and custodians in instructions for bonds. However, investors commented that this area was a problem as most market players were still using the local codes. Several market participants mentioned Thailand as a problem in this area.</td>
<td>OK</td>
<td>LOW</td>
</tr>
<tr>
<td>Matching</td>
<td>There are trade matching and settlement pre-matching systems for bond trades.</td>
<td>OK</td>
<td>OK</td>
</tr>
<tr>
<td>Dematerialisation</td>
<td>All government (and some corporate bonds - depending on the registrar agents) are dematerialised.</td>
<td>LOW</td>
<td>LOW</td>
</tr>
<tr>
<td>Regulatory framework</td>
<td>The perceived regulatory risk, especially fear of capital controls, is a factor that deters foreign investors. Investors commented that the regulations can be complex and unclear, and that regulations are changed too often and sometimes without enough notice.</td>
<td>-</td>
<td>HIGH</td>
</tr>
</tbody>
</table>
Definitions

The following list presents some of the definitions commonly used in discussion on clearing and settlement topics.

Extract from P.286 BIS Papers No 30 « Clearing, settlement and depository issues »
http://www.bis.org/publ/bppdf/bispap30z.pdf

Clearing. Generally, clearing refers to the process of comparing trades before settlement date or the determination of the net obligations of the broker participants (for both securities and cash). In certain publications, clearing may be used synonymously with settlement.

Settlement. The settlement process refers to the exchange of cash and securities on the contractual settlement date. The settlement date can be agreed upon at trade execution or can be prescribed by local trading conventions. Settlement may be processed on a provisional or a final basis.

Settlement finality. The exchange of cash and securities is final when a settlement can no longer be unwound. Finality eliminates the main legal risks of payment and settlement systems, reduces systemic risk and ensures the smooth operation of a system.

Gross settlement. Gross settlement systems settle transactions on an instruction by instruction and real-time (RTGS) basis throughout the day. RTGS systems are costly due to the need for collateral or available cash balances to cover payment obligations during the day or for securities lending programmes to cover short securities positions. RTGS systems, however, typically reduce systemic risk.

Net settlement. In net settlement systems, obligations are settled at the end of the business day on a net basis. The net process is subject to potential systemic risk, due to the contagion effect where incoming funds are relied upon to make onward payments when a participant cannot meet his obligations. As there is no requirement to post collateral or keep cash balances readily available during the day, net systems tend to be less costly.

Central securities depository (CSD). A CSD is either the physical entity or the system that facilitates the settlement and safekeeping of securities and ensures the reconciliation of participant accounts. Securities can be safekept in immobilised or dematerialised form. Settlement generally occurs in book entry form.

International central securities depository (ICSD). An ICSD is a depository settling trades in international and various domestic securities, usually through direct and indirect links with agents in the domestic markets. The best known ICSDs are Euroclear Bank and Clearstream International. The eurobond market developed in part in response to operational and regulatory inefficiencies in domestic bond markets.

Central counterparty (CCP). A CCP acts as counterparty to every buy and sell trade, a process known as “novation”. This process concentrates counterparty risk and provides multilateral netting.
Contributors to the making of this market guide

- Soramon Chaithanaguloingkol, Market Supervision Department, SEC, Thailand
- Ariya T., Thai BMA
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- Deutsche Bank
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ABMF SF-1

Vietnam Bond Market Guide

Version: No.7_21/June/2011
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   J. Meetings of bondholders
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   L. Options available on the bond market
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   D. Repo market is not operational enough.
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X. Next Step → Future Direction
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   B. G-30 Compliance
I. High Level Structure, Type & Characteristics of the Market

Overview of the Vietnam (VN) domestic bond market:

In recent years, Viet Nam's bond market has improved significantly as the Government continues to initiate reforms and pass enabling legislation.

Local government bonds—both in VND and USD—are issued in large lots while streamlined procedures continue to ease corporate bond issuance. Government bonds dominate the debt market, followed by municipal and then corporate bonds. Maturities vary from less than 1 year to 15 years. Convertible bonds have also been introduced.

Bonds are typically purchased at initial auctions by insurance companies, banks, and individuals; and are held until maturity. In the absence of mutual funds and pension funds, banks dare key players.

A number of licensed securities companies are authorized to provide a full range of securities services—including underwriting, brokerage, advisory, portfolio management, and trading.

The Government has used “equitization” of state-owned enterprises (SOEs) as one of the major tools for expanding the equity side of the capital market without committing itself to outright privatization of state enterprises.

In September 2003, the State Securities Commission (SSC) issued the Capital Market Roadmap with the development of the bond market as one of its key aims. There are three phases of the Roadmap, which can be found by following the link. [http://www.adb.org/Documents/Books/VIE_Capital_Market_Roadmap/](http://www.adb.org/Documents/Books/VIE_Capital_Market_Roadmap/)

The Government’s first international bond issuance in October 2005 was a resounding success. It has issued local bonds denominated in US dollars to attract domestic savings. A number of SOEs plan to issue both local and international bonds.

A. Types of Bonds

1. By issuer category

   a. Bonds issued by public entities

      Currently, there are three categories of government instruments in the market: Government bonds, Treasury bills (Tbills), and government related corporate bonds.

      All listed fixed income securities are immobilized at the VSD and are transferred electronically. The settlement cycle is T+1.

      i. Treasury bills

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1 In this context, equitization means restructuring and IPO.
Treasury bills are not traded on the local exchanges and are only available to commercial banks that maintain accounts with the State Bank of Vietnam (SBV).

ii. Government bonds

Government bonds are issued by the Ministry of Finance (MOF) of Vietnam via the State Treasury and/or authorised issuers such as Vietnam Development Bank (VDB) (policy bank). VDB bonds are regarded as Government bond.

Theoretically those bonds can be held either as registered or bearer instruments denominated in Vietnamese Dong (VND). But most of them are scripless. Those are listed on the Hanoi Stock Exchange (HNX) with an average size of USD20m equiv. Ceiling rates are defined by MOF.

Approximately 90% of all bonds issued in VN are Government Bonds, and they are scripless (dematerialised by book-entry system within the Vietnam Securities Depository (VSD)) and their OTC trade is matched via put-through deals on the Hanoi Stock Exchange (HNX) system.

Listing of bonds means in this country that the Exchange is used for trade matching purpose.

Vietnam successfully launched their maiden sovereign bond issue (denominated in US dollar) in October 2005, and US$ 1 billion sovereign bond proceeds were to finance key refinery, power, and cargo ship projects in September 2007.

In February 2009, the government issued the first government’s USD denominated bonds to the domestic investors.

Specialized Government bond system:

In September 2009, a specialized Government bond system was put into operation on HNX.

All Government bonds issued through bidding and underwriting were listed and traded on the system.

As of December 31, 2010, 501 Government bonds had been traded. The total trading value was VND 225,000 billion, equivalent to 12% of GDP.

Designed with two trading types - outright trading and repo trading, the specialized Government bond trading system has been operated in a stable, secure way that fulfills the needs of market participants. The total trading value in 2010 reached VN D93,770 billion, with an average value of VND375 billion per session in which the value of outright trading was VND90,664 billion and that of repo trading was VND 3,105 billion, equivalent to 96.7% and 3.3% of the total market trading value, respectively.

Bonds of two year remaining maturity were most frequently traded, accounting for 30% of total market trading values, followed by three-year (22.6%), one-year (17.8%) and 10-year maturity bonds (12%).
The number of market participants has developed impressively.

At the opening date on September 24, 2009, there were 30 market participants. One year later it had attracted 13 new members, with 26 securities companies and 17 foreign commercial banks involved in total.

Commercial banks have played an important role in creating secondary market liquidity through securities dealing.

Especially, trading and interest from commercial bank members operating in both capital and monetary markets contributed to an increased connection between the markets.

Bond market information was distributed in an Auto manner to regulator, market participants and investors through diversified information infrastructure systems including infobonds, websites, bulletins and information vendors.

Besides, HNX carried out electronic storage and data accumulation from different sources to secure electronic data for the bond market.

In the primary market, the Government bonds issued through bidding gradually developed with transparency to attract more capital mobilization players.

In 2010, HNX organized 48 bidding sessions with a total mobilized value of VND 28,317 billion (an 11-fold increase compared to 2009, accounting for 50% of total State revenue from Government bond issuances in 2010).

The significant milestone in bidding activities in 2010 was that HNX cooperated with the State Treasury to drastically boost bidding in big lots from May, 2010.

This was a successful move to increase secondary market liquidity and gradually create a standard yield, support macro management and help investors and organizations follow price fluctuations in Government bond types.

The connection between the primary and secondary Government bond markets was considerably improved.

In terms of yields, secondary market information reflected financial market realities. Specifically, the trading yields of 1-year, 2-year, 3-year bonds decrease a tendency from mid June 2010 in line with the tendency of issuing Government bond market and money market.

Besides, the growth in trading scale showed that the Government bond system initially had an impact on capital turnover channels between members.

Thus, besides monetary market and open market operations (OMO), the Government bond market supported members’ liquidity, especially in tight liquidity situations.

iii. Municipal bonds
Municipal bonds are used for financing specific projects, and typically have a tenor of one year or more with an average size of USD10m equiv. Only 3 known issuers; Ho Chi Minh City, Hanoi and Dong Nai Province, tightly controlled by central government. Ceiling rates are defined by MOF (c.a. 20-30bps over Government bonds).

b. Bonds issued by private entities and public entities

iv. Corporate bonds

Under the new Decree 52/2006, joint-stock companies, State-owned enterprises being restructured into limited liability companies, and foreign invested companies operating in Vietnam would be eligible to issue bonds. The new decree stipulates that enterprises would be fully responsible for issuing the bonds and making subsequent bond payments, and states capital raised from bonds should only be used for investment projects, resettlement of long and medium-term loans, and raising operational capital. Bond issuances must also be executed in a transparent manner guaranteeing the rights of investors.

To be eligible, companies will have to satisfy conditions of operating for at least one year, file an audited financial report demonstrating profitable operations in the previous year, and seek approval from relevant authorities of their issuance plan.

Corporate bonds are issued by companies and state-owned enterprises (SOE). These bonds can be held in bearer or registered form, and normally categorized as unlisted bonds at the outset.

Unlisted corporate bonds are registered and held in the form of securities booklets and are generally safe kept in bank vaults. In this case banks also play a role of registrar. By fulfilling certain conditions these bonds are transferred to HNX.

Most of them have face value of VND 1,000,000 while several large SOE bonds have face value of VND 1,000,000,000 and a tenor of 5 years or more.

Convertible bonds were first issued in 2006 and denominated in VND.

Corporate bonds market has grown rapidly in 2009 due to improvement in legal framework.

c. Money Markets Instruments

The commonly available money market instruments apart from time deposits and CD are:

i. Treasury bills
Treasury Bills are issued by the State Treasury at tenors less than 1 year

ii. State Bank of Vietnam bills
These are discounted securities with a face value of VND 100 million at tenors of one, three, six and nine months (with 6 month tenor being the most
common). This instrument is issued to finance the State Bank of Vietnam (SBV)'s monetary policy. These 2 types of bills are issued in the form of book-entry and kept in custody with the SBV. These bills are open market instruments.

iii. Repos of Government and Municipal Bonds:

Repos were introduced in 2003 between local securities firms, foreign banks and some financial companies.

2. By listing status

a. Bonds listed and traded on the HNX(The Hanoi Stock Exchange) or HOSE(Ho Chi Minh Stock Exchange)

In securities law, listing is to make eligible securities to be transacted at the Stock Exchanges Securities Trading Centres.

Listed bonds in Vietnam generally means that (1) the Exchange is used for trade matching purpose as Securities Trading Centre, (2) the securities are scripless (dematerialized by book-entry system) and (3) registered and settled at the Vietnam Securities Depository (VSD). Transfer of ownership occurs simultaneously with settlement.

In this listed bonds case trade is done OTC (not on the Exchange) but trade matching is done in HNX / HOSE system. In this case registrar is HNX / HOSE.

In securities law, securities registration means the record of ownership and other rights of securities owners.

In June 2008, all government bonds with maturity dates of at least six months in the future were moved from the HOSE to the HNX.

The purpose of Bond listing on the Exchange in this country means (1) profiling purpose, (2) for regulatory purpose, (3) price discovery purposes and (4) providing trade matching system in the Exchange.

b. Bonds non-listed and traded over-the-counter (OTC)

Unlisted public companies’ securities are immobilised by book-entry system within the Vietnam Securities Depository (VSD), and transfer of ownership occurs simultaneously with settlement. In this case VSD is registrar (book-entry account holder).

Other non-listed bonds are registered and held in the form of securities booklets and are generally safe kept in bank (local custodian) vaults. In this case banks play a role of registrar.

c. Corporate bond transfer to HNX

Bonds of private companies and state owned companies are transferred to the HNX, upon fulfilling the following listing criteria:
i. Minimum paid-in capital of VND 10 billion

ii. The issuing company needs to be a stock company, a limited liability company or a state-owned enterprise

iii. Should be profitable business operations for two consecutive years prior to applying for listing

iv. Minimum 50 bond-holders

3. By note forms

   a. Government bonds are scripless (dematerialised by book-entry system within the Vietnam Securities Depository (VSD)).
   b. Corporate bonds may be in bearer form or registered form.
   c. Global Notes are not applicable in the Vietnam market.

B. Methods of Issuing and settlement of Bonds

Bonds are typically purchased at initial auctions by insurance companies, banks, and individuals; and are held until maturity. In the absence of mutual funds and pension funds, banks dare key players.

1. Government Debt

   Government bonds have tenors of 2, 5, 7, or 10 years and are issued by the Ministry of Finance (MOF) with a minimum par value of VND100,000.

   All government bonds are listed within two to three weeks after being issued and are in dematerialized form.

   T-bills have tenors of 1, 3, 6, or 9 months and are issued by the State Treasury and the SBV are in physical form.

   The Ministry of Finance limits T-bill purchases and trading to local or overseas Vietnamese organizations or individuals and foreign organizations or individuals working and living in Vietnam.

   Therefore, foreign investors without a legal presence in Vietnam are prohibited from trading T-bills.

2. Corporate Debt

   Corporate bonds are issued by corporations in convertible, bearer or registered form with a minimum par value of VND100,000 and a tenor of one year or more.

   Corporate bonds are normally in physical form until being listed.

   At 11:30 on TD, the HOSE and the HNX send all the data on matched trades to the VSD. Between 14:00 and 16:00, the VSD provides reports on matched trades of
bonds to depository participants. Depository participants check these reports, send notification to their clients, and affirm the trades to the VSD by 08:30 on T+1.

The VSD nets securities and cash for all affirmed trades on a multilateral basis and provides net securities and cash settlement reports to the participants by 16:00 on TD. By 16:30, the VSD checks the availability of securities in depository participants’ accounts and notifies those participants with a short securities position so that they can borrow from other participants.

If a depository participant cannot cover a short securities position, the VSD will consider cancelling the trade. By 11:00 on T+1, depository participants must transfer their net cash obligations to their cash settlement accounts at the BIDV. The VSD checks the availability of funds in these accounts at 11:30.

Depository participants with a short cash position can borrow from the settlement compensation fund or obtain a mandatory loan from the BIDV.

From 13:00 to 14:00, the BIDV transfers cash to the net delivering depository participants’ clearing and settlement cash accounts at the BIDV. The VSD transfers the securities from the net delivering participants' omnibus clients’ transaction accounts to the members’ clearing and settlement securities accounts at the VSD.

Between 14:00 and 14:30, the BIDV transfers cash to the VSD’s cash settlement account at the BIDV and confirms the fund movement to the VSD.

The VSD transfers securities from net delivering depository participants’ net clearing and settlement accounts to the VSD’s settlement account.

Between 14:30 and 14:45, the BIDV transfers the cash balances from the VSD’s cash settlement account to the net receiving depository participants’ clearing and settlement cash accounts at the BIDV and confirms the movement to the VSD.

The VSD transfers securities from its settlement account to the net receiving depository participants’ clearing and settlement accounts.

Between 14:45 and 15:00, the BIDV transfers the cash balances from the net receivable depository participants’ clearing and settlement cash accounts to their cash settlement accounts and confirms to the VSD.

The VSD transfers securities from net receivable depository participants’ clearing and settlement accounts to their omnibus clients’ transaction accounts.

The transfer of securities to the receiving members’ transaction accounts represents completion of securities settlement.

Only convertible bonds for unlisted public companies registered for the UPCOM market are traded on UPCOM. Currently, no convertible bonds are listed on UPCOM and the VSD has not yet issued clearing and settlement guidelines.

C. Credit-Rating Agencies and Credit Rating of Bonds

There is no domestic credit rating agency in this country.

Global rating agencies such as Standard & Poor’s (S&P), Moody’s Investor Service,
Fitch Ratings, and Rating and Investment Information (R&I) have assigned credit ratings for Viet Nam.

Rating selection involves information gathering, analysis, and monitoring of the financial health of an issuing entity. The rating methodologies and procedures for each rating agency can be found by following the links provided below.

Viet Nam's first credit rating agency, Vietnamnet Credit Ratings Centre, opened in June 2005, but discontinued its operations after less than one year. A link below provides information regarding Vietnamnet.

http://english.vietnamnet.vn/reports/2006/06/580857/

D. Bond Related Systems for Investor Protections (Disclosure rules)

Issue authorization and disclosure duties for public offering bonds:
After registration, actual bond issues should obtain SSC’s (the State Securities Commission) authorization for issuance of bonds with a set of disclosure information.

1. Conditions for offering bonds to the public:
   a. The enterprise must have its paid-up charter capital at the time of registering for public offering of at least 10 billion VND in book value;
   b. Being profit-making in the year preceding the year of such registration for offering; having no accumulated losses up to the year of registration for offering or overdue debts over than 1 year.
   c. Having a plan for offering and use and refund of capital received from the offering approved by the Board of Management, the Board of Members or the enterprise’s owner.
   d. Having commitments to fulfill obligations of the issuer towards investors, regarding the conditions for issuance and payment, ensuring the investors’ legitimate rights and interests and other conditions.

2. The Government shall stipulate the conditions for offering securities to the public applicable to State owned enterprises, foreign invested enterprises which are transformed into joint stock companies; and newly established enterprises in the fields of infrastructure or high technology; offering of securities overseas and other specific cases.

3. Registration of offering securities to the public
   a. The issuer carrying out the offering of securities to the public shall have to register with the State Securities Commission.
   b. The following cases shall not be subject to registration for offering securities to the public:
      i. Offering of bonds of the Vietnamese government;
      ii. Offering of international financial institutions’ bonds accepted by the Vietnamese Government;
      iii. Offering of shares to the public by State owned enterprises which are transformed into joint stock companies;
iv. The sale of securities upon a court judgment or decision or the sale of securities by the managers or the persons entitled to assets in case of bankruptcy or insolvency.

4. Information prior to the public securities offering

During the time the State Securities Commission reviews the public securities offering registration dossier, the issuer, the underwriter(s) and other relevant organisations and individuals may only use, in a honest and accurate manner, the information described in the Prospectus submitted to the State Securities Commission to explore the market, provided that they shall clearly specify that the information on the date of issue and the securities selling price is the proposed information. The exploration of markets must not be conducted through the mass media.

5. Effectiveness of the public securities offering registration

a. Within 30 days as from the date of receiving the valid dossier, the State Securities Commission shall examine and grant the Certificate for Public Securities Offering. In case of refusal, the State Securities Commission must respond in writing and clarify the reasons thereof.

b. The Certificate for Public Securities Offering granted by the State Securities Commission shall be a document certifying that the public securities offering registration dossier fully satisfies the conditions and procedures provided by the law.

c. Within 7 days as from the date the Certificate for Public Securities Offering comes into effect, the issuer shall have to publish the Announcement of Offering in 3 consecutives issues of one electronic newspaper or written newspaper.

d. Securities shall only be offered to the public after the announcement has been made as stipulated in clause 3 of this Article.

6. Distribution of securities

a. The distribution of securities shall only be conducted after the issuer ensures that securities buyers can access the prospectus in the public securities offering registration dossier announced at places mentioned in the Announcement of Offering.

b. The issuer, the underwriter or issuing agency must distribute securities in a fair and public manner and ensure that the time limit for registration of buying securities applicable to investors is at least 20 days; such time limit shall be stipulated in the Announcement of Offering.

c. In case that the amount of securities registered to buy exceeds the amount of securities permitted to be issued, the issuer or the underwriter shall have to distribute out the securities permitted to be issued to the investors in proportion with their purchase registration rate.

d. The money paid for securities shall be transferred into a blocked bank account until the issue is completed and reported to the State Securities Commission.

E. Governing laws of bond issuance

Regulations related to corporate bond / government bond

1. Government bond:
   Decree 01/2011/ND-CP, and
Decision No. 2111QD-TTg dated 13th February 2009 on foreign-currency dominated bond.

Decree 01/2011/ND-CP on issuing sovereign bonds, government bonds, government-guarantee debts and local governance debts took effect from February 20, 2011, and it is expected to boost the development of Vietnam's bond market.

The Decree 01, which was released to replace the Decree 141, will be the legal basis for standardise activities in the primary government bond market.

a. General speaking, the Decree 01 contains many new messages on the formation of a professional and effective bond market in accordance with standard international practices. This new decree makes many important changes such as linking government bonds issuance activity with public debt management under the new Law on Public Debt Management, effective from last year.

b. The decree also unifies both foreign and local government bond issuance in a single decree instead of two decrees as previously, namely the Decree 141 and Decree 53/2009/ND-CP regarding the issuance of international bonds.

c. In addition, the decree allows government bond issuance to be used to restructure debts and debt portfolios, as well as allowing bond swapping and the buying back of bonds before the due date. This is an important step as it paves the way to restructuring the currently small and fragmented bond market.

d. Another positive aspect of the Decree 01 is that it requires Ministry of Finance (MOF) to gradually set up a market maker system to raise bond market liquidity. Membership conditions have been prescribed by the MOF and are outlined in the decree. Participants in bidding and bond underwriting practices specified in the decree will be considered and recognised as system members provided they satisfy these conditions.

e. The new decree provides clearer and stricter regulations regarding bond issuance and buying and this will allow for more effective control of capital usage for government bonds. While the Decree 141 restricted the use of capital from bond issuance to offset the budget deficit in the annual estimation approved by the National Assembly, the Decree 01 allows government bond issuance not only to compensate the temporary deficit budget and to be used as budget expenditure for developing investment, but also to restructure government debts by lending to other organisations as well as to ensure national financial security. As such, it will help issuers to use the government bond capital more flexibly and effectively and create conditions favourable to maintaining continuous and regular issuance to help develop the market.

2. Corporate bond:

a. Securities Law 2006 No. 70/2006/QH11;


c. Law amending and supplementing a number of articles of Securities Law No. 62/2010/QH12 dated 24th November 2010;
d. Decree No. 52/2006/ND-CP dated 19th May 2006 issuing corporate bond;

e. Circular No. 17/2007/TT-BTC dated 13th March 2007 detailing IPQ (corporate bond included);

F. Transfers of interests in bonds

Listed bonds: entry in the Vietnam Securities depository.

Unlisted bonds: depends upon charter and terms and conditions of the bonds, but normally the issue of new bond certificates and entry into bond register of the issuer.

Transfer of securities ownership: Article 54 of Securities Law No. 70/2006/QH11:

1. The transfer of securities ownership with respect to categories of securities registered at the Securities Depository Centre shall be undertaken via VSD (Vietnam Securities Depository);

2. The validity of the transfer of securities ownership at VSD shall be as follows:

   a. Where securities have been centrally deposited at VSD, the transfer of securities ownership shall take effect on the date of book-entry in the securities depository account at VSD.

   b. Where the securities have not been centrally deposited at VSD, the transfer of securities ownership shall take effect on the date of recording on the securities registration book managed by VSD.


The transfer of ownership of listed / registered for trading securities shall be subject to the following principles: Any securities holder intends to transfer his ownership of securities shall deposit such securities at VSD via depository members to buy or sell such securities via Stock Exchanges or transfer his ownership as prescribed in Clause b of this Article (except for any transfer of ownership due to inheritance factors or the fact that the issuer redeems its shares from employees upon employment termination).

- VSD shall only execute transfers of ownership of securities outside its securities trading system if such transfers are non-commercial or fail to be executed via trading systems at Stock Exchanges. Such transfers shall include the following cases:

  + Making as a present, inheriting according to the Civil Law

  + Odd-lot transactions according to the law of securities and securities market.

  + Issuers/Labor unions of issuer buyback preferred shares of their employee which terminate their labor contracts to become treasury shares and bonus shares for their current employee.

  + Issuers use treasury shares to bonus/Labor union of issuer distribute bonus shares for their employee.
Foundation shareholder transactions in restricted time.

Issuers change their strategic shareholders in restricted time.

In case if securities have registered in VSD and have accepted in principal by Exchanges but have not listed on Exchanges yet.

Investors leave securities in trust for fund manager in case fund manager accepts to manage trusted investment portfolio by assets.

Different from equity, there is no general meeting for bond holders. Bond is debt instrument so that the rights of bond holder are stipulated according to Decree 01/2011/ND-CP:

Bondholder are guaranteed for in-time and sufficient settlement of interest and principal.

Bondholder has entitlement to transferring, giving, making as a present, inheriting, discounting and pledging in credit relationship and civil relationship according to current law.

As for guarantee for bond settlement

As for corporate bond which guaranteed by government (according to Decree 01/2011/ND-CP): the government commits to protect bondholder's interests.

As for guaranteed corporate bonds (according to Clause 44 Decree 52/2006/ND-CP): if the issuer fails in interest and principal settlement, the guaranteed asset will be liquidated to refund the due debt. In case other credit organizations are settlement guarantor, they have responsibilities to refund the debt to bondholder.

In VN now there has no specified company system to guarantee for corporate bond settlement.

G. Definition of securities

Law on Securities: Pursuant to Article 3 of Amended & supplemented Securities Law No. 62/2010/QH12 and Article 6 of Securities Law No. 70/2006/QH11, Securities means evidence from an issuing organization certifying the lawful rights and interest of an owner with respect to an assets or capital portion. Securities may take the form of certificates, book-entries or electronic data, and shall comprise the following types:

1. Shares, bonds and investment fund certificates;

2. Share purchase rights (rights issue), warrants, call options, put options, future contracts, groups of securities and securities indices;

3. Investment capital contribution contracts;

4. Other types of securities stipulated by Ministry of Finance.
H. Self-governing rules behind the market


Vietnam Bond Market Association (VBMA) is a non-profit organization aimed to promote the professional and effective development of Vietnam Bond market, guarantee the legitimate rights and interests of members and at the same time ensure the national interests.

1. VBMA’s roles and function

   a. Standardise trading practices and market conventions for bonds and other debt instruments of similar nature in the Vietnamese bond market;

   b. Enhance the regional and international integration of the Bond Market in general and of the members in particular through encouraging the adoption of global best practices by market participants under the conditions of the Vietnamese bond market;

   c. Establish the code of conduct and ethics to govern the relationship of market participants to ensure the equality among them;

   d. Improve market expertise and skills by conducting activities to aggregate and analyse bond information, consulting, training and provision of facilitating services to Members and other related participants in trading bonds and other debt instruments of similar nature in the Vietnamese bond market;

   e. Being a forum and bridge for exchanging and updating bond information, for strengthening collaboration and mutual understanding among its Members and between its Members and the Vietnamese regulatory authorities as well as the related international organizations; to make comments on related policies; to support the state competent bodies in improving policies and legal framework for the bond market in Vietnam; and

   f. Update, aggregate, store and build up a date base on bond market information, thus helps to increase the transparency of the Vietnamese Bond Market.

2. History of VBMA

In the recent years, the Government has been conducting a reform of Vietnam’s financial market. Besides the state’s actions, many organizations, businesses as well as the bond market participants have made great effort to contribute to develop the bond market. In November 2006 a group of local and international commercial banks, securities companies, fund management companies, and insurance companies formed the Vietnam Bond Market Forum (VNBF) that was intended to promote bond trading through disseminating and sharing market information, and standardizing commercial activities in the bond market in Vietnam.

The Forum was directed by an executive board that was voted out from the representatives of the members that were active in the Vietnamese Bond Market. The Forum’s executive board worked on a part-time basis, met monthly to discuss on and consent to the Forum’s plan of activities and allocation of work. Over a period of three years, the VNBF’s activities brought about initial results for the market development.
However, operating under the form of a forum, VNBF faced its own limitations such as matters concerning legal status, fundraising, and public recognition.

In March 2007, VNBF members collaborated and decided to start procedures to apply for an official permit for the establishment of a professional association in compliance with the laws of Vietnam, thus helped to raise its legal status and financial capacity aimed to strengthen activities in order to effectively and practically contribute to the development of the bond market in general and bring about benefits to the members in particular. The association was named the Vietnam Bond Market Association (VBMA).

At that time VNBF had a total of more than 50 members, and planned to increase the number to 100 or more when it becomes an association. Vietnam’s authorities such as the State Securities Commission, the Ministry of Finance, and the State Bank of Vietnam were all in favor of the transformation from a forum to an association. VNBF officially established its office in May 2007, with an executive board secretary working full-time and being responsible for the operations of the office.

The draft charter was first completed in June 2008. In August 2008, the Ministry of Finance approved the list of the Preparation Committee for establishing the VBMA. On May 22, 2009 the Minister of Interior issued an official decision allowing the establishment of the Vietnam Bond Market Association.

On December 31, 2009 based on the submission letter of the Association’s Chairman, the Minister of Interior decided to approve VBMA’s Charter, thus legally enabled the Association to set up its management and execution bodies aimed to execute and coordinate VBMA’s activities. The Executive Committee, Standing Committee, VBMA Office commenced operating since early 2010 and have been stabilized their operations step by step.

At the end of November 2010 VBMA has 59 members, of which there are 54 institutional members being local and foreign commercial banks, companies in finance, leasing, securities, fund management, insurance and law consultancy, and 5 individual members.

3. 09/01/2009 Released of the Code of Conduct
The Code of Conduct (COC) is intended to be observed by the VBMA member organizations, which engage in bond trading activities, whether as part of their market making or proprietary trading, and/or brokerage services for bond transactions. Its main aim is to set out the principles and standards which the VBMA members should follow when conducting bond trading business in a manner that exhibits a high degree of professionalism, integrity, and fairness.

Based on the proposal made by the VBMA, the Ministry of Finance officially authorized the Association to release the COC.

To confirm commitment 21 full and associate members gave their signatures at spot to the MOU for Adherence to the COC and Agreement to supply information to VBMA’s website, in witnesses of the representatives from the MOF, SSC, HNX, VSD, international agency and local TV. Other members suggested signing the MOU in due course as they were not able to attend the AM or need an opinion of the legal department as a procedure before signing. http://www.vbma.org.vn/vbma/downloadFile?fileid=59

I. Bankruptcy procedures

In Vietnam, bankruptcy situation of the bond issuer has not occurred yet. If it happens, the bankruptcy law will be applied.

J. Meetings of bondholders

In Vietnam, there is no official concept of the Meetings of bondholders yet.

K. Event of default

Bond settlement default:
In present, the settlement default in bond transactions which trade on exchanges have not occurred yet. If the default occurs in securities or cash settlement, the principal and resolution sequence according to settlement regulations of VSD.

In VN, there has no precedent of the default of issuer in interest and principal settlement. However, bondholder is creditor of issuer so if it happens, the bankruptcy law will be applied No. 2112004/QH11, issuer will announce the bankruptcy status.

L. Options available on the bond market

There is nothing to be mentioned so far.

M. Parties involved in a bond issue and their respective roles

Viet Nam’s bond market participants include issuers from the government and corporate sectors.

Major bond investors include commercial banks and domestic life insurance companies.

A number of authorized securities companies and a few market associations also
participate in the market.

However, a domestic rating agency currently does not exist.

1. Government

The Government forms a large share of bond issuers in Viet Nam, in particular the central government and state-owned enterprises. Corporate issuers represent a small share of the bond market.

The national government is the largest issuer of debt securities and the Viet Nam Development Bank, which issues government-guaranteed bonds, is the second largest issuer.

Municipal bonds: issued by city municipalities and provincial governments. Issuers include Ho Chi Minh City and the State Bank of Viet Nam (SBV).

Corporate bonds: issued by SOE’s and private enterprises. State-owned enterprises (SOEs) also form a large number of bond issues in Viet Nam. For example, PetroVietnam was the first SOE to issue bonds and others are expected to follow suit as the equitization of SOEs progresses. The Bank for Investment and Development of Viet Nam (BIDV) signed an agreement with the Debt Asset Trading Corporation to assist in the financial restructuring of SOEs, including the issuance of bonds for its own financing needs.

2. Investors

Domestic investor base are still small. Ability to absorb supply and demand shocks are limited.

Commercial banks and domestic life insurance companies are the major bond investors in Viet Nam.


Domestic life insurance companies have placed 49% of their total investments in government bonds. Manulife Viet Nam Insurance Company and Prudential Viet Nam are the first two wholly-foreign-owned life insurance companies in Viet Nam. Other insurance companies include Bao Viet Insurance, Bao Minh Insurance, and Vien Dong Insurance. The Government is considering streamlining the insurance industry to mobilize additional capital.

Other institutional investors include Viet Nam’s Social Security Fund, finance companies, securities firms, and, more recently, investment funds. In March 2004, the Vietnam Fund Management Company (VFM) introduced the Vietnam Securities Investment Fund (VF1), which was the country’s first securities investment fund. VFM is a joint venture between Sacombank and Dragon Capital. About one third of VF1’s capital is invested in long-term government bonds. Other investment funds include Vinacapital and the aforementioned Dragon Capital.

Off-shore investors are still limited (no limitation on foreign holdings of bonds).
3. Intermediaries

A number of licensed securities companies are authorized to offer a full range of securities services including underwriting, brokerage, advisory, portfolio management, and trading. Foreign banks are also licensed as custodian banks for foreign individual and institutional investors in the securities trading centers. A list of securities companies is linked below.

4. Other Market associations

   a. Vietnam Association of Securities Business

      Established in May 2004, the Vietnam Association of Securities Business comprises 13 licensed securities companies and an investment fund management company.

      The association facilitates relations among its members and acts as a link among market participants, securities trading agencies, state entities, financial organizations, and investors.

   b. The Vietnam Association of Financial Investors

      The Vietnam Association of Financial Investors (VAFI) brings together investors, policymakers, and financial advisers to strengthen and enhance Viet Nam’s capital markets.
II. Primary and secondary market regulatory frameworks

A. Vietnam market Regulatory Structure

1. Regulatory Environment

The Ministry of Finance (MOF) and the State Bank of Vietnam (SBV) jointly regulate the capital markets.

The SBV is the central bank and chief regulatory body for all issues affecting the banking industry. The SBV administers monetary, credit and banking regulations and issues regulations on matters such as exchange controls, interest rates, and banking license application procedures.

The State Securities Commission (SSC), which reports to the Minister of Finance, regulates the securities market. The HOSE, HNX, and VSD are under SSC jurisdiction and are required to adhere to regulations relating to accounting, auditing, and statistical reporting.

2. The State Securities Commission (SSC)

http://www.ssc.gov.vn/portal/page/portal/ssc_en

The State Securities Commission (SSC) regulates and acts as the supervisory agency for the securities market, and the HOSE and the HNX.

All exchange regulations are issued by the SSC which has power to suspend trading in securities, delete listings of companies in order to protect investors’ interests and grant/revoke licenses relating to securities issuance, brokerage and custody services.

With effect from March 2004, the SSC fell under the jurisdiction of the MOF of Vietnam.

Following are some important functions of SSC:

a. Reporting to the MOF legal documentation relating to securities and securities markets, its strategies, matrixes, long-term and annual plans.

b. Advising the MOF to set up, suspends, or disperses the operations of the Stock Exchanges, the Vietnam Securities Depository (VSD) and other institutions related to the securities market.

c. Ensuring that proper reporting by participants is done.

d. Setting standard procedures and process to be applied in organisation under applicable laws in the securities and securities market.

e. Issuing, suspending or revoking certificates of registration of securities.

f. Supervising the compliance of rules and regulations.

g. Implementing regular inspections and proving guidelines to securities and securities markets.

h. Organising scientific researches and analyses in securities and securities market.
i. Managing the modernisation of the securities market as per stipulated laws

j. Providing training programs to market participants.

In addition to the above, the SSC also performs other duties and functions assigned by the Ministry of Finance.

3. Ministry of Finance (MOF)

http://www.mof.gov.vn/portal/page/portal/mof_en

The functions of the Ministry of Finance (MOF) as a government agency include:

a. Managing the State budget;

b. Managing the collection of tax, fees and other revenues under the State budget;

c. Managing the budget fund, the State reserve fund and other State financial funds;

d. Managing national reserves and State assets;

e. Managing government borrowing and debt servicing from domestic and abroad; and international grants;

f. Issuing government bonds

In addition, the MOF is also responsible for:

a. Regulation of banks and non-bank institutions

b. Participating in the management of the stock market.

4. State Bank of Vietnam (SBV)

http://www.sbv.gov.vn/wps/portal/lut/p/c4/04_SBV8K8xLLM9MSSzPy8xBz9CP0os3hnd0cPE3MfAwN3r0BnA093r2ALEydDAwMDc_2CbEdFALpR3bJ/

The SBV is the central bank of Vietnam. Its main functions are to formulate and implement the national monetary policy, stabilise currency, control inflation, improve socio-economic development; manage currency and banking activities and contribute to the development of the market structure. It regulates foreign exchange control for stock market activities.

The operational functions of the SBV are as follows:

a. Implementation of the National Monetary Policy:

   - Outlining and implementing annual plan of the Monetary Policy
   - Apply instruments to manage flow of money in and out of the economy by providing refinancing, monitoring exchange rates, ensuring reserves and in co-operate open market professional operations.

b. Issuance of Notes and Coins

   - Introducing, control and supervision of the implementation of monetary issuance regulation.

c. Credit Operations

   - Lending short-term loans to approved credit organisation under crisis
d. Account Opening, Payment and Cash Operations
   - Open accounts with international banks and monetary institutions
   - Provide inter-bank payment system and services
   - Conducts transaction for the State Treasury

e. Foreign Exchange Management:
   - Outline and introduce legal documents with respect to foreign exchange policy
   - Issuance and suspension of foreign exchange operation licence
   - Management of Foreign Exchange Reserves
   - Buy and sell foreign exchange in the international market as per regulations

f. Market Information:
   - Information service on currency and banking operations provided to organisation
   - Publish periodic information on financial operations

5. Stock Exchanges

The Ho Chi Minh Stock Exchange (HOSE) and the Hanoi Stock Exchange (HNX) serve as the secondary markets infrastructure for fixed income market infrastructure provider in Vietnam.

In June 2008, all government bonds with maturity dates of at least six months in the future were moved from the HOSE to the HNX.

With the goal of developing the Vietnamese government bond market, the MOF has set up a scheme to develop the bond market which includes a development roadmap for both primary and secondary markets.

Based on this strategy, the specialized government bond system, which officially came into operation in September 2009, has been important in developing the secondary market infrastructure.

The specialized government bond system opened in September 2009, beginning with 25 members, and covers government bonds, local government bonds, and other government guaranteed securities, with an initial total listing value of VND 166 trillion (US $9.3 billion).

All government bonds have since been moved to the new platform. In addition small numbers of corporate bonds are now trading in this market.

After one year of operation, the government bond market saw positive changes such as increased convenience in bond trading and the support of more transparent and professional information for investors.

The Decree 01/2011/ND-CP, which was released to replace the Decree 141, will be the legal basis for standardise activities in the primary government bond market.

Hanoi and Ho Chi Minh Stock Exchanges are government-owned and operated under the oversight of the State Securities Commission (SSC).
Each exchange offers Trading Memberships to local market participants.

The Vietnam Securities Depository (VSD) provides depository services and depository members to local market participants. The VSD commenced operations in May 2006.

HNX uses a locally-built clearing system while HOSE uses a system provided by Thailand.

B. Important Legislation and regulation in VN market (Issuing debt instruments related regulations / rules)

In September 2005, limits on aggregate foreign investment were increased from 30% to 49% of listed equities. There are no separate individual investment limits in equities for foreign investors.

There are no foreign investor limits for fixed income market.

For listed company in banking industry, a different limit is applied. For Sacombank, which starts listing on HOSE since Jul 12, 2006 a foreign investor limit of 30% is promulgated by the State Bank of Vietnam.

1. A key legislation regulating securities and the securities market

A key legislation regulating securities and the securities market is the Securities Law 2006 (No 70/2006/QH11) which took effect from January 1, 2007. The scope of the Law covers the public offers of securities, listing and trading securities, conducting business and investing in securities, securities services and the securities market.

It is applicable to all Vietnamese and foreign institutional and retail investors, and all other organizations and individuals involved in securities activities and stock market.


<table>
<thead>
<tr>
<th>Article 6. Definition of terms</th>
</tr>
</thead>
<tbody>
<tr>
<td>10. Investors means domestic or foreign institutions and individuals participating in investment in the securities market.</td>
</tr>
<tr>
<td>11. Professional securities investors mean commercial banks, financial companies, financial leasing companies, insurance organisations and securities trading organisations.</td>
</tr>
<tr>
<td>12. Public offering means an offering of securities according to one of the following methods: (a) Via mass media, including Internet; (b) Offering of securities to 100 investors or more, excluding professional investors; (c) Offering to an unspecified number of investors.</td>
</tr>
<tr>
<td>17. Listing is to make eligible securities to be transacted at the Stock Exchanges or Securities Trading Centres.</td>
</tr>
</tbody>
</table>

CHAPTER II OFFERING OF SECURITIES TO THE PUBLIC

Article 10. Face value of securities

2. The par value of bonds to be offered to the public shall be VND 100,000 and multiples of VND 100,000.

Article 12. Conditions for offering securities to the public
2. Conditions for offering bonds to the public:

(a) The enterprise must have its paid-up charter capital at the time of registering for public offering of at least 10 billion VND in book value;

(b) Being profit-making in the year preceding the year of such registration for offering; having no accumulated losses up to the year of registration for offering or overdue debts over than 1 year.

(c) Having a plan for offering and use and refund of capital received from the offering approved by the Board of Management, the Board of Members or the enterprise’s owner.

(d) Having commitments to fulfill obligations of the issuer towards investors, regarding the conditions for issuance and payment, ensuring the investors’ legitimate rights and interests and other conditions.

4. The Government shall stipulate the conditions for offering securities to the public applicable to State owned enterprises, foreign invested enterprises which are transformed into joint stock companies; and newly established enterprises in the fields of infrastructure or high technology; offering of securities overseas and other specific cases.

Article 13. Registration of offering securities to the public

1. The issuer carrying out the offering of securities to the public shall have to register with the State Securities Commission.

2. The following cases shall not be subject to registration for offering securities to the public:

(a) Offering of bonds of the Vietnamese government;

(b) Offering of international financial institutions’ bonds accepted by the Vietnamese Government;

(c) Offering of shares to the public by State owned enterprises which are transformed into joint stock companies;

(d) The sale of securities upon a court judgment or decision or the sale of securities by the managers or the persons entitled to assets in case of bankruptcy or insolvency.

Article 14. Dossier of public securities offering registration

2. The dossier for registration of offering of bonds to the public shall include:

(a) The registration of offering of bonds to the public;

(b) The prospectus;

(c) The Charter of the Issuer;

(d) Decisions of the Board of Management or the Board of Members or the enterprise’s owner approving of the plan for offering and use and repayment of capital received from the public bond offering;

(dd) The commitment to fulfill the issuer’s obligations to investors, regarding the conditions for issuance, payment and ensuring the investors’ legitimate rights and interests and other conditions.

(e) Underwriting commitment (if any).

Article 15. The prospectus

1. Regarding the offering of shares or bonds to the public, the prospectus shall include the following information:

(a) Brief information on the issuer, including its model of organizational apparatus, business activities, property, financial situation, the Board of Management or the Board of Members, or the company’s owner, the (General) Director, the Deputy (General) Director and shareholder structure (if any);

(b) Information on the offering and securities to be offered, including conditions for offering, risk factors, the proposed plan of profits and dividends of the most recent year following the issuance of securities, the plan of issue and use of
capital received from the offering;

(c) The financial statements of the issuer for the latest 2 years as stipulated in Article 16 of this Law;

(d) Other information as stipulated in the Prospectus Form.

4. The Ministry of Finance shall provide the form of the Prospectus.

Article 16. Financial statements

1. A financial statement includes the balance sheet, the report on production and business results, cash flow report and presentation of the financial statement;

2. In case where the issuer is a holding company, it shall have to submit a consolidated financial statement in accordance with the law on accounting.

3. Annual financial statements must be audited by the approved auditing company.

4. In case where the dossier is submitted before the 1st March annually, the financial statements of the preceding year in the initial dossier may be unaudited, but the audited financial statements of the last 2 consecutive years must be presented.

5. Where the period from the end of the most recent financial statement to the time of submission of the valid dossier of registration for public offering of securities to the State Securities Commission is more than 90 days, the issuer must make additional financial statements up to the most recent month or quarter.

Article 17. Responsibilities of organisations or individuals in relation to the dossier of registration for offering of securities to the public

1. The issuer shall be responsible for the accuracy, honesty and adequacy of dossier of public securities offering.

2. The issuing consultancy companies, the underwriters, the approved auditing companies and the signatories of the auditor's report and any organisations or individuals certifying the dossier must be responsible within their scope relating to the dossier of public securities offering.

Article 18. Amendments, supplements of the dossier of registration for public securities offering

1. During the time of examination of the public securities offering registration dossier, the issuer shall be obliged to amend or supplement the registration dossier if it discovers that the registration dossier contains inaccurate information on an important issue, or omits any important content that must be included in the dossier as stipulated, or where it's deemed necessary to provide explanation for any matter that may cause any misleading.

Article 19. Information prior to the public securities offering

During the time the State Securities Commission reviews the public securities offering registration dossier, the issuer, the underwriter(s) and other relevant organisations and individuals may only use, in a honest and accurate manner, the information described in the Prospectus submitted to the State Securities Commission to explore the market, provided that they shall clearly specify that the information on the date of issue and the securities selling price is the proposed information. The exploration of markets must not be conducted through the mass media.

Article 20. Effectiveness of the public securities offering registration

1. **Within 30 days** as from the date of receiving the valid dossier, the State Securities Commission shall examine and grant the Certificate for Public Securities Offering. In case of refusal, the State Securities Commission must respond in writing and clarify the reasons thereof.

2. The Certificate for Public Securities Offering granted by the State Securities Commission shall be a document certifying that the public securities offering
registration dossier fully satisfies the conditions and procedures provided by the law.

3. **Within 7 days** as from the date the Certificate for Public Securities Offering comes into effect, the issuer shall have to publish the Announcement of Offering in 3 consecutive issues of one electronic newspaper or written newspaper.

4. Securities shall only be offered to the public after the announcement has been made as stipulated in clause 3 of this Article.

### Article 21. Distribution of securities

1. The distribution of securities shall only be conducted after the issuer ensures that securities buyers can access the prospectus in the public securities offering registration dossier announced at places mentioned in the Announcement of Offering.

2. The issuer, the underwriter or issuing agency must distribute securities in a fair and public manner and ensure that the time limit for registration of buying securities applicable to investors is **at least 20 days**; such time limit shall be stipulated in the Announcement of Offering.

   In case that the amount of securities registered to buy exceeds the amount of securities permitted to be issued, the issuer or the underwriter shall have to distribute out the securities permitted to be issued to the investors in proportion with their purchase registration rate.

3. **The money paid for securities shall be transferred into a blocked bank account until the issue is completed and reported to the State Securities Commission.**

4. The issuer shall complete the distribution of securities **within 90 days** from the effective date of the Certificate for Public Securities Offering. In case where the issuer cannot complete the distribution of securities to the public within such time limit, the State Securities Commission shall consider for its extension which must not exceed 30 days.

   In case of registration of securities offering in a number of tranches, the period between the one tranche and the next tranche must **not exceed 12 months**.

5. The issuer or the underwriter shall report the offering result to the State Securities Commission within 10 days from the date of completing the offering, together with the certification of the bank where the blocked account is opened for the money received in the tranche.

6. The issuer, the underwriter or issuing agency shall **transfer the securities or the certificate of securities ownership to the buyers within 30 days** from the date of completing the offering.

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2. **Special regulation - Regulating investment activities for foreign investors**

   A special regulation regulating investment activities for foreign investors is Decision No.121/2008/QD-BTC on December 24, 2008 which took effect from February 17, 2009.

   This Decision provides detailed guidelines for foreign investors to conduct investment in the Vietnam stock exchanges, of which, general principles have been provided for ease of reference.

3. **Restrictions for foreign investors**

   The Vietnamese market is basically open to local and foreign investors. However, foreign investors need to obtain a **securities trading code** prior to being allowed to invest in the stock market.
In general, the aggregate foreign ownership limit (FOL) for listed equities and funds is 49%. Except for Vietnamese banks, there is, in general, no foreign ownership limit in equities for individual institutional investors or for individual investors.

The following table summarizes the individual and aggregate foreign ownership limits for banks. In addition, there is usually a lock-up period for strategic foreign investors.

### Foreign ownership limit (FOL) for listed equities and funds

<table>
<thead>
<tr>
<th></th>
<th>Strategic Foreign Investors</th>
<th>Non-strategic Foreign Investors</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Banks</strong></td>
<td>Individual (including its affiliates): 15% (20% with Prime Minister’s approval in exceptional cases)</td>
<td>Individual (including its affiliates): 10%</td>
</tr>
<tr>
<td></td>
<td>Aggregate: 30%</td>
<td>Aggregate: 30%</td>
</tr>
<tr>
<td><strong>Non-banks</strong></td>
<td>N/A as only foreign banks are qualified as strategic foreign investors</td>
<td>Individual (including its affiliates): 5%</td>
</tr>
<tr>
<td></td>
<td>Aggregate: 30%</td>
<td></td>
</tr>
</tbody>
</table>

I.E. Currently,

a. Aggregate foreign ownership of listed/unlisted public companies is limited to 49% and unlisted private companies are limited to 30%. A shareholder having a holding of 5% or more is considered as major shareholder. Though there is no cap on foreign investor of holding shares in listed companies, the major shareholders via custodian bank or directly should report to the HOSE/HNX and declare/announce in the daily Stock Exchange Bulletin a change in their holding of 1%.

b. Aggregate foreign ownership of listed or unlisted banks is limited to 30%, maximum individual foreign investor of 5%, maximum organisational foreign investor of 10%, maximum strategic foreign investor of 15%, application for share purchase should be submitted to the State Bank of Vietnam for specific approval.

c. **There is no foreign ownership restriction for bonds.**

d. The MOF limits T-bill purchases and trading to local or overseas Vietnamese organizations or individuals, and foreign organizations or individuals working and living in Vietnam. Therefore, foreign investors without a legal presence in Vietnam are prohibited from trading T-bills denominated in local currency or foreign currency and government bonds denominated in foreign currency.

4. **Securities Trading Code**

Foreign investors that wish to invest in Vietnam must first apply to the VSD in order to obtain a Securities Trading Code.

The application is comprised of the following documents:

a. The ‘Application for Registration of Securities Trading Code’ form, which is a standard form. An authorized signatory of the foreign investor must sign this
b. The ‘Information Slip of Foreign Institutional Investor’ form, which is a standard form. An authorized signatory of the foreign investor must sign this form. A Notary Public or equivalent authority from the foreign investor’s country of registration must also certify this form.

c. The ‘Information Slip of Appointed Representative of Foreign Institutional Investor’, which is a standard form. The same individual that signed the ‘Information Slip of Foreign Institutional Investor’ must sign this form. A Notary Public or equivalent authority from the foreign investor’s country of residency must also certify this form.

e. The ‘Letter of Appointment of Foreign Institutional Investor’s Representative’, which is a set form. The form must be certified by the foreign investment organization and a competent agency.

f. Copies of the license of establishment of the investor organization, notarized or verified by a notary public or equivalent entity of the investor’s country, and the license of establishment of the organization or its branch(es) in Vietnam (if any) notarized or verified by a competent Vietnamese agency.

Where a foreign investor is an investment fund, the application should also include a copy of the fund’s charter or its Memorandum of Understanding, the charter of the fund management company, financial statements for the last two consecutive years, and a summary of its targets and operations in Vietnam.

All documents and forms listed in the above must be translated to Vietnamese, and the Vietnamese State Notary Public Office must notarize the translated version.

In addition, foreign investors that wish to invest in unlisted securities must also register a Capital Contribution Account with SBV.

Depository members will update the VSD on account opening and closing on a daily basis via the electronic linkage system or via hard copy by 16:00.

The VSD will verify the provided information and send confirmation at 08:30, 11:30 and 16:30 via the electronic linkage system or email.

In the case of custodian change, VSD will only process the update upon completion of assets transfer. The timeline to correct information discrepancies is 1 business day.

C. Substantial Shareholder Reporting Requirements

Disclosure requirements apply to investors holding more than 5% of the capital of a listed company; where investors will have to file a report to the respective regulators within 7 days from the date of settlement.

If disclosure is not done within stipulated time, the trading system would reject that particular trade when foreign ownership limit is reached.

These guidelines were first outlined in Circular No. 38-2007-TT-BTC issued by the Ministry of Finance on April 8, 2007, and was further elaborated when the Ho Chi Minh Stock Exchange (HOSE)’s Decision No.59/QD-TTGĐCKHCM issued on June 8, 2007.
This Decision reflects the essence of Circular No. 38/2007/TT-BTC and provides a more detailed guideline for all HOSE’s participants.

The key part which impacts foreign investors relates to substantial holding disclosure reporting, which is required each time the investor’s holding crosses the 5% level.

In addition, at each 1% increment above the 5% level or when ownership falls below the 5%, filing of disclosure reports is also required.

This report should be filed with the regulators (HOSE) within 7 working days, and would then be made known to the public.

Foreign investors and/or affiliated persons who intend to hold up to 25% of the issuing company’s paid-up capital or are holding 25% of a listed company should send disclosure report to the HOSE so that the HOSE releases the disclosure and advise the listed company within 3 working days before the trade date.

D. Buying debt instruments related regulations / rules (Investment in debt securities)

1. Unless otherwise stated in the prospectus, offer document, term sheet or similar document etc., there is no restriction on the types of investors who are eligible for investing in particular debt instruments.

2. Foreign investors, whether institutional or retail, should however ascertain whether it is permitted under the law of their jurisdictions.

E. Investor Protections

1. Bankruptcy Law and application for companies operating in financial services

   There are several measures to protect investors in accordance with the Securities Law (No 70/2006/QH11) which took effect from January 1, 2007 and the various regulations applicable to trading activities and related issues.

   Based on the amended Constitution of the Socialist Republic of Vietnam, the Bankruptcy Law No. 21/2004/QH-11 was issued on June 15, 2004 to regulate the bankruptcy-related issues applicable for enterprises and co-operatives in Vietnam.

   The Decision No. 114/2008/ND-CP was published on Nov 3, 2008, which gives further guidance on several Articles in the Bankruptcy Law and application for companies operating in insurance industry, securities services and financial services.

   The guidance mainly covers the bankruptcy procedure required for bankrupt companies, including procedure for bankruptcy document submission, payment recovery plan, asset dissolution, and bankruptcy announcement.

   The decision mentions the regulatory authorities, the MOF and the State Securities Commission of Vietnam (SSC) apart from the judge, being the two main bodies involving in the review of the bankruptcy process of the companies.

   These regulatory bodies have authority require the enterprises to conduct necessary steps to recover their payment capacity and financial conditions or to further process the bankruptcy procedures as needed.
**Insurance company** could be required to increase capital or to execute reinsurance to recover its financial status.

Whilst **Securities Company** could be required to transfer its rights and obligations to another securities company to fulfill its responsibilities to its customers in case it is at risk of payment capability.

Otherwise, the SSC must appoint an appropriate securities company to handle such incurred duties.

Limitation and suspense to company assets' usage, procedure for asset dissolution and void transactions are also specified in the guidance.

Upon the decision to open the bankruptcy procedure, for Securities Company, activities such as doing brokerage services or opening securities accounts are required to terminate or activities such as borrowing or ownership transferring of shares or assets must obtain approval from the judge.

Asset dissolution steps at insurance companies, securities companies and financial companies are also listed in the order ranging from total auction of the company to the enterprise in the same industry to separate asset selling in case the mentioned suction is failed.

The decision has taken effect since November 14, 2008. Any offence in relating to the execution of this guidance, the Article No.93 in the Bankruptcy Law will be implemented.

2. **Settlement assistance fund**

A **settlement assistance fund** has been set up for investor protection.

A flat fee of VND 120 million has to be paid by a broker/custodian at the time of admission as a participant.

The fees are then put aside for investor protection purposes. Further, participants have to contribute 0.01% on their annual turnover of the previous year but not more than VND 2 billion per annum to this fund.

Moreover, the compulsory loan facility can be utilized whenever a depository member is temporarily short of liquidity for settlement and the shortage amount is more than VND 10 billion; this loan facility agreement (signed with the designated clearing bank) should be in place before utilization. The interest rate is decided by the designated clearing bank on the borrowing date.

There are also stringent requirements and reporting to be filed with HOSE, HNX and VSD when required. Companies have to make the filing within 24 hours if so requested by the HOSE, HNX and VSD.

The broker / custodians’ proprietary assets have to be segregated from their clients’ / third parities’ assets. Brokerage firms have to execute investors’ orders before their own orders.
F. Capital Contribution Account Report

Foreign investors are required to file annual and quarterly reports to the SBV on the cash movements in the investor’s capital contribution account (CCA), as well as unlisted securities holdings and capital contribution to unlisted companies in Vietnam.

The report must contain the following information:

1. full name, address, business type, CCA account number, commercial bank where the CCA is opened, and the number of the CCA approval letter,
2. balance in the CCA account at the beginning and the end of the quarter/year and movements during the period, and
3. The total value of unlisted securities holdings, capital contribution and other holdings.

The reporting deadline is the fifth day of the next month for the quarterly report and January 10 for the annual report. Failure to comply with this reporting requirement might lead to the withdrawal of the CCA approval.

G. Issuing debt instruments related regulations / rules

1. Issuing Corporate Bonds
   a. Securities Law 2006:
      Refer B.1 above for extract.
      This Securities Law stipulates that issuer wishes to make public offering of bond must prepare certain necessary documents and follow disclosure requirements, prior to a formal approval by the State Securities Commission. It stipulates the issuer’s responsibilities to maintain healthy financials conditions and to meet its financial obligations to bondholders.
      This law clearly mentions disclosure rules and practices for issuer.
   b. The Enterprise Law 2005
      The Enterprise Law 2005 stipulates that they have rights to issue corporate bonds, convertible bonds and other types of bonds, in conformity to laws and the company charter. (Article88. Issuance of bonds)
      The Law prohibits enterprises from issuing bonds when they do not exhibit a sound financial position, having signals of either low debt servicing capability or below-average profitability.
      I.E. Company is not allowed to issue bonds if:
      a) It fails to make full repayment for the principal and interest of issued bonds or do not pay or make full payment of due debts in the last 3 consecutive years
      b) The average after-tax-profit rate in the last three consecutive years is not higher than interest proposed to pay for bonds to be issued.
c. Decree 52/2006/ND-CP

The Decree 52/2006/ND-CP by the government of Vietnam stipulates details which enable eligible enterprises to issue bonds.

d. Decision 07/2008/QD-NHNN

Decision 07/2008/QD-NHNN by the State Bank of Vietnam governs particularly credit institutions operating in Vietnam, including state-run and joint-stock commercial banks, foreign bank branches, 100%-foreign-owned banks, and banking joint-ventures.

The above law and regulations constitute a regulatory framework for issuing corporate bonds.

2. Issuing Bonds transfer to the HNX

Bonds of private companies and state owned companies are transferred to the HNX, upon fulfilling the following listing criteria:

a. Minimum paid-in capital of VND 10 billion

b. The issuing company needs to be a stock company, a limited liability company or a state-owned enterprise

c. Should be profitable business operations for two consecutive years prior to applying for listing

d. Minimum 50 bond-holders

H. securities identification system

HOSE and HNX each maintain a local numbering system for the securities listed in their respective exchanges.

The local code for fixed income is an eight digit alphanumeric code. The local code for the securities investment funds that are currently listed in the market is a six digit alphanumeric code.

In 2008, the State Securities Commission (SSC) signed Decision 388 on the implementation plan to issue ISIN codes for Vietnamese securities. To date, ISIN codes have been issued for all listed securities, including equities and fixed income.

The market allows investors the option of using ISIN codes, rather than local codes, in their trade and settlement instructions.

I. Taxation Framework and Tax requirements

Per the newly issued Personal Income Tax (PIT) law, Decision No. 100/2008/ND-CP dated September 8, 2008 and Circular No. 84/2008/TT-BTC dated September 30, 2008, retail investors (both resident and non-resident) are currently taxed on dividend, interest of bonds, capital gains and certain securities.
Duties and Taxes

<table>
<thead>
<tr>
<th>Duty</th>
<th>Fixed income</th>
</tr>
</thead>
<tbody>
<tr>
<td>Capital Gains Tax</td>
<td>N/A</td>
</tr>
<tr>
<td>Income tax on Sales Proceeds</td>
<td>0.10% of transaction value</td>
</tr>
<tr>
<td>Withholding Tax*</td>
<td>10%</td>
</tr>
<tr>
<td>Stamp Duty</td>
<td>0</td>
</tr>
<tr>
<td>Value Added Tax</td>
<td>0</td>
</tr>
</tbody>
</table>

* The investors pay 10 percent of the interest received during each interest payment period. Previously investors paid 0.10 percent withholding tax on the total face value of the bond plus the interest received.

Foreign institutional investors including foreign investment funds which have no legal presence in Vietnam are subject to income tax on a deemed basis.

The deemed income tax rate is 0.1% of equity sales proceeds and sales of investment certificates for each transaction.

For listed shares, the securities company (ie the brokers) is responsible for withholding, reporting, paying and finalising the tax with the tax authorities on behalf of the customers. For non-listed shares, if the issuers authorised the brokers to manage the shareholder registrar and monitor the transfer procedures, the withholding and payment obligation also rest with the brokers. Otherwise, it will rest with the issuers.

Profits distributed by the investment funds to both resident and non-resident institutional investors are subject to 20% withholding tax, except the profits which are sourced from dividends which were already subject to corporate income tax at the ordinary business. The investment fund management company is responsible for withholding, reporting and paying the tax on behalf of the investors.

Interest earned by investors from investment in bonds which are exempt from income tax in accordance with the current regulations is not subject to income tax. In other cases, 10% withholding tax would in principle apply to interest income from investment in bonds.

J. Tax exemption requirements for non-residents

Foreign institutional investors, including foreign investment funds, that have no legal presence in Vietnam, are subject to income tax on a deemed basis.

For listed securities, the securities company (i.e. the broker) is responsible for withholding, reporting, paying, and finalizing the tax with the tax authorities on behalf of the customers.

For non-listed securities, if the issuers authorize the brokers to manage the shareholder registrar and monitor the transfer procedures, the withholding and payment obligation also rests with the brokers. Otherwise, it will rest with the custodian banks.

K. Definition of “professional investors” in the VN market

1. Item 11, Article 6 Securities Law No. 70/2006/QH11 defines that "Institutional investors are commercial banks, financial companies, financial leasing companies,
insurance organisations and securities trading organizations”.

2. Not clear about the concepts of wholesale and retail in this market.

3. Private placement (non-public offering) concept is not clearly defined in the Laws and regulations in VN.

4. Private placement (non-public offering) is not regulated in VN.
III. Trading of Bonds and Trading Market Infrastructure

A. OTC market trading system of Bonds in Vietnam
   (From the global custodian (State Street) point of view)

Note: Bond trading is normally executed via negotiation method. Hence, trades are often agreed between counterparties before being entered into the Stock Exchange trading system.

1a. Client and counterparty agree on bond trade details directly or place the trade order with the Licensed Brokers.

1b. Under current practice, Brokers execute bond trades via negotiation method directly with counterparty and input trades to the Exchange, i.e., trades are executed before TD. (TD is the date Brokers enter the trades to the trading system.)

2. Client sends settlement instructions to State Street by TD-1 at 16:00 EST.

3. State Street sends settlement instructions to the Subcustodian.

   – Trade Date

4. After checking cash/securities availability with the Subcustodian, Broker inputs the order into the Stock Exchange trading system for matching.
5. Stock Exchange matches orders and issues confirmation of trade execution to the Broker and reports trade details to Vietnam Securities Depository (VSD).

6. Broker confirms trade details back to the Client and the Subcustodian between 13:00 and 14:00.

7. VSD confirms trade details to the Subcustodian between 14:00 and 16:00.

8. Subcustodian provides trade details to State Street upon receipt of the bond trade confirmation from the Broker and the VSD.

9. In case of mismatch, Subcustodian requests that Broker provide evidence (e.g., trade order of the client) that the trade is correctly executed. If the Broker can provide valid evidence, the trade must be settled in accordance with the regulation. Subcustodian liaises with State Street to obtain amended instruction. State Street sends amended instruction to Subcustodian by 19:00 on TD.

   - Trade Date +1

10. If Broker cannot provide valid evidence, Subcustodian disputes to the VSD by 08:30 on TD+1 (SD). Depository participants must report error trades to the VSD by 08:30 on TD+1 (SD). It does not mean that the trade can be cancelled. Trade can only be cancelled when there is no solution and the default party must bear all costs/losses. The party who makes error should be responsible to settle the trade.

11. By 08:30, Subcustodian/Broker proposes solution to the VSD for trade correction if there is any error reported on trade date. In most cases, Broker will borrow securities from other participants or use their own portfolio to settle. Based on the proposal, VSD will re-allocate the securities and send the post-trade correction notification to the relevant participants.

12. Depository participants fund their cash settlement accounts at the Bank for Investment and Development of Vietnam (BIDV), the market’s clearing bank, for their net cash obligation by 11:00.

13. BIDV checks availability of funds in these accounts and reports to the VSD by 11:30.

14. From 13:00 to 14:00, BIDV transfers the cash to the net delivering depository participants’ clearing and settlement cash accounts at the BIDV while VSD transfers the securities from the participants’ omnibus clients’ transaction accounts to the participants’ clearing and settlement securities accounts at the VSD.

15. Between 14:00 and 14:30, BIDV transfers cash to VSD’s cash settlement account at BIDV and confirms the fund movement to VSD. VSD transfers securities from all depository participants’ clearing and settlement accounts to VSD’s settlement account.

16. Between 14:30 and 14:45, BIDV transfers the cash balances from VSD’s cash settlement account to net receiving depository participants’ clearing and settlement cash accounts at the BIDV and confirms to the VSD. VSD transfers securities from its settlement account to depository participant’s clearing and settlement accounts.

17. Between 14:45 and 15:00, BIDV transfers the cash balances from depository participant’s clearing and settlement cash accounts to depository participants’ cash settlement accounts and confirms to the VSD. VSD transfers securities from depository
participant’s clearing and settlement accounts to participants’ omnibus clients’
transaction accounts.

18. Sub-custodian confirms settlement to State Street.
19. State Street provides confirmation to the Client

[From Trade flows: government and corporate bonds provide by STATESTREET]

B. Bond Repurchase Market

Repo transactions for government bonds are available in the HNX. From August 2008, some local securities companies have restarted repo services for select clients and share portfolios. The SSC issued a draft Circular on repo transactions on 1 October 2009, which when finalized will serve as the repo market’s regulatory framework.

C. VIET NAM Bond Transaction Flow (For Foreign Investors)

OTC Bond Transaction Flow for Foreign Investors

Description of Steps

Trade date: T-1
Trade Capture date: T
Settlement Date: T+1

1. Foreign Institutional Investor sends FX/funding instruction to Global Custodian (for planned bond trades)
2. Global Custodian sends FX/funding instruction to Domestic Custodian (to ensure timely availability of VND)
3. Domestic Custodian sends FX confirmation to Global Custodian
4. Foreign Institutional Investor places order with International Broker
5. International Broker places order, typically with Domestic Bank
6. Domestic Broker/Bank trade OTC with Counterparty (via phone), both parties sign trade agreement (contract)
7. Domestic Broker/Bank sends trade confirmation to International Broker, and to Domestic Custodian
8. International Broker sends trade confirmation to Foreign Institutional Investor
9. Foreign Institutional Investor sends securities settlement instruction to Global Custodian
10. Global Custodian instructs Domestic Custodian on securities settlement details
11. Domestic Bank relays trade details to Domestic Broker (as HNX member) for trade capture
12. Domestic Broker checks available funds/bonds with Domestic Custodian
13. Domestic Broker captures trade details on HNX, typically via eBond front-end system
14. VSD provides Settlement Report to Domestic Custodian (at end of 'Trade Date')
15. Only in the event of a discrepancy, does Domestic Custodian need to contact VSD (hence dashed arrow)
16. Domestic Custodian provides settlement/matching status to Global Custodian
17. Domestic Custodian effects funding of BIDV account
18. After settlement deadline, Domestic Custodian retrieves settlement confirmation from VSD (hardcopy, or online)
19. After settlement deadline, Domestic Custodian retrieves cash debit/credit confirmations from BIDV (hardcopy)
20. Domestic Custodian sends settlement confirmation to Global Custodian
21. Global Custodian effects funding of account with Domestic Custodian, or into FCY nostro account (before end of day)
22. Global Custodian sends settlement confirmation to Foreign Institutional Investor
23. Domestic Custodian sends securities statement to Global Custodian
24. Domestic Custodian sends debit/credit information in cash statement to Global Custodian
25. Global Custodian sends cash statement to Foreign Institutional Investor

OTC Bond Transaction Flow for Foreign Investors Additional Comments

- The bond market in Viet Nam is OTC, but all bond trades will need to be captured in HNX system (ETS) eventually
- Official settlement cycle = T+1; but T equals trade capture date, hence effective settlement cycle at least = T+2
- In addition to brokers, banks and other FIs can participate in bond trading; official participation judged by eBond (ETS front-end system) membership; typical bond dealers are banks
- Domestic Bank in diagram often equals Domestic Custodian
- Government and corporate bonds are nowadays only traded on HNX; however, some residual bonds (both government and corporate) remain on HOSE until maturity.
- Pre-matching, in effect, is done at the custodian, based on broker confirmation and client instructions received
- 1 – FX/funding instruction early more out of practicality than need: market effectively T+2, so FII may want to secure FX spot rate, also may require confirmation from Domestic Custodian that sufficient liquidity available by SD; however, FII could send funding instruction by T, as long as before balance enquiry by broker
• 11, 13 – Traditionally, bank trades with counterparty, then passes trade detail to broker for capture in HNX system (this because traditionally only brokers were members of the exchange); however, since late 2010, banks can access eBond system directly
• 14 – VSD provides Settlement Report, in effect future settlement report, after checking bond balances
• 15 – This step only required in case of discrepancies in settlement details; then, Domestic Custodian would need to inform VSD of need for amendment or cancellation; actual change in conjunction with counterparty
• 16 – Matching/status updates as reporting on pre-matching at custodian, and matching between broker confirmation and counterparty input as evident in VSD Settlement Report
• 18, 19 – Market participants assume settlement after VSD, BIDV cut-off times, since any discrepancy would have been identified in earlier steps
• 21 – Funding equals the settlement of the pre-booked FX, in effect giving FII sort of intra-day facility, since FX will settle through Domestic Custodian’s FCY nostro (before the end of the day)
• 23, 24 – Sequence assumes since securities statement tends to be generated earlier than cash statement by banks

[ADB Consultant: MS]
IV. Possible item of Impediments / Restrictions

The Government bond market showed a few weaknesses.

A. Liquidity in the secondary market is lacking

The Government bond market liquidity needs to improve, with the number of bond codes traded during 2010 having accounted for 40% of the listed bond codes in the system. The market's turnover is about 35% of the whole market, which was relatively low.

B. Market's listing scale increased

In addition, the whole market's listing scale increased; the listing scale of each particular bond code was small, which resulted in difficulties for investors in choosing bond codes to trade. Meanwhile, market membership needs to be further diversified and the standard of bond trading needs to be improved.

C. Imbalance in bond terms

The weaknesses included an imbalance in bond terms issued on the primary market. While winning volumes of 2, 3 and 5-year bonds were quite high, the numbers for 10 and 15-year bonds were relatively low.

D. Repo market is not operational enough.

E. Securities Lending:

The current regulations do not permit securities lending in the Vietnam market. However, there is “supported lending” that takes place between securities companies when a securities company is unable to meet its settlement obligations with the VSD.

F. No-regulation related to private placement market

G. Market Entrance Requirements (Heavy non-resident requirements)

Securities trading code (STC)

Before establishing an account and trading in listed and/or unlisted securities in Vietnam, foreign investors must apply to the VSD to obtain a securities trading code (STC). The VSD uses the STC to monitor foreign ownership limits in the equity market.

According to local regulations, foreign investors are:

a. individuals with foreign nationalities residing in foreign laws and the branches of such organizations, including branches in Vietnam;

b. organizations established and operated under foreign laws and the branches of such organizations, including branches in Vietnam;

c. wholly foreign-owned organizations set up and operated under Vietnamese laws and the branches of such organizations;

d. investment funds founded and operated under foreign laws and the 100% foreign-invested funds established and operated under Vietnamese laws; or

e. Other cases per separate stipulation by the Prime Minister.
Applications for and STC must include the following documents, which will be forwarded to the VSD.

The investor must complete the VSD’s Securities Trading Code Application Form for Offshore Foreign Institutional Investors to invest in Vietnam’s Securities Markets, which must be signed by an authorized signatory of the applicant’s office.
If the investor is under a fund-sub-fund structure, when applying for an STC the account must be named either:

a. the name of the sub-fund, or
b. Name of the fund – name of the sub-fund.

The investor must provide supporting documents to prove the legal status of the applicant.
Investors must ensure that the names are consistent between supporting documents and that they exactly match the name used on the application form.
If the names do not match, documentation showing the change in name must also be submitted.

[From 2010 The Guide to Custody in World Markets, Vietnam provided by STATESTREET]
V. High level description of the securities settlement system

A. Securities settlement infrastructure

B. HNX – The Hanoi Stock Exchange
C. HOSE – Ho Chi Minh Stock Exchange
D. VSD – Vietnam Securities Depository
E. BIDV – Bank for Investment and Development of Vietnam
B. Settlement cycle

The settlement cycle for both listed and unlisted market is T (Trade Capture Date)+1.

On (T date) post morning trading session, the HOSE/HNX processes all trades. At 15:30 custodian banks/securities firms receive confirmed trade date and advice for settlement.

Based on the confirmed settlement amount and number of bonds advice received from the HOSE/HNX on T+1 morning, the custodian bank debits the client’s account and transfer the fund to its account with the designated bank to ensure that by the end of the morning clearing session, the settlement fund is transfer made after the regulated settlement cycle cut off time (T+1) by the custodian bank is considered a violation of the current settlement regulation.

C. Settlement Method

Book-entry system.

D. Definition of Clearing and settlement

1. Securities Clearing

According to Item 7 and Item 8 of Article 2 - Decision No. 87/2007/QDBTC on registration, depository, clearing and settlement of securities, securities clearing includes bilateral clearing and multilateral clearing.

- **Bilateral clearing** means the method of clearing securities transactions which have been matched during the same day between any two trading parties with respect to the one type of securities, in order to determine the net sum and securities which must be settled by both parties.

- **Multilateral clearing** means the method of clearing securities transactions which have been matched during the same day between all trading parties with respect to the one type of securities, in order to determine the net sum and securities which must be settled by both parties.

A. Securities settlement

Securities delivery is made by VSD, cash payment is made by the Settlement Bank, and the Deliver versus Payment principle is to be observed.

Settlement for securities transactions at stock exchanges are made based on
multi-netting results with T + 1 settlement cycle for bonds.

VSD organizes settlement for securities trading transactions at stock exchanges as follows:

+ As for securities: VSD clears transactions and transfer securities via VSD’s account and depository accounts of selling and buying members opened at VSD.

+ As for cash: VSD clears cash for each member at each market. Concurrently, The Settlement Bank (BIDV) makes payment for securities transactions via cash accounts of members and VSD opened at the Bank.

According to Article 32 of Decision No. 87/2007/QD-BTC, VSD settles securities based on bilateral and multilateral clearing results, and then settles each transaction of securities which has been listed and unlisted.

Settlement bank effects payment order according to cash clearing results sent by VSD.

Cash and securities settlement is the last post-trade activities to complete securities transactions, i.e. both parties fulfill their obligations: based on cash and securities clearing results, the seller delivers securities and the buyer delivers payment.

Article 3 of VSD guideline on securities clearing and settlement: VSD shall clear securities, funds and settle securities transactions in accordance with the principles prescribed in Articles 32 and 33 of the Guidelines on Securities Registration, Depository, Clearing and Settlement issued with Decision No. 8712007/QDBTC dated October 22, 2007 by the Minister of Finance and Article 11 of Circular No. 43/2010/TT-BTC dated March 25, 2010 by the Minister of Finance on amending and supplementing the Guidelines on Securities Registration, Depository, Clearing and Settlement issued with Decision No. 87/2007/QD-BTC dated October 22, 2007 by the Minister of Finance.

Cash clearing shall be made for each member by each market. For transactions of stocks, fund certificates and corporate bonds listed and registered for trading on stock exchanges, cash of each member shall be transferred on the basis that VSD shall clear the amount receivable and the amount payable for transactions executed at the same time and with the same settlement method at stock exchanges.
Transaction settlement shall be made based on the principles of delivery versus payment (DVP).

VSD clears settlement obligations (the receivables and the payables) towards transactions of listed stocks, fund certificates, corporate bonds having the same payment time and manner at two Stock Exchanges with a view to calculating settlement obligations to receive or to pay through each depository member.

[From Market Profile provided by Citi, and Domestic Custody Services, Market Guide Vietnam, July 2009, p.17]
VI. Cost and charging methods

Fees are determined under a mutual agreement between securities companies, investment management companies and its customers. However, the fees have been applicable according to Circular No.: 01/2000/TT-UBCK on April 17, 2000 and Circular No.: 02/2000/TT-UBCK on November 14, 2000 effective from November 29, 2008.

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Percentage of Fees / Commission</th>
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<tbody>
<tr>
<td>Brokerage Commission</td>
<td>- Shares, Fund Certificates: Not more than 0.5% of the value</td>
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<tr>
<td></td>
<td>- Bonds: Not more than 0.15% of the value</td>
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<tr>
<td>Underwriting Fees</td>
<td>Not more than 3% of the underwritten sum</td>
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<tr>
<td>Investment Consultancy Fees</td>
<td>Percentage decided by mutual agreement</td>
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<tr>
<td>Fund Management Fees</td>
<td>Not more than 2% of the asset value</td>
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<tr>
<td>Portfolio Management Fees</td>
<td>Not more than 2% of the asset value</td>
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<tr>
<td>Domestic Fund Administration</td>
<td>Not more than 0.15% of assets value under administration</td>
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<tr>
<td>Custodian Fees</td>
<td>As prescribed by the VSD</td>
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</table>

New Fee Schedule Applicable on the Stock Exchanges (SE) and the Vietnam Securities Depository (VSD)

In accordance with the Decision No 1351/QD-BTC on June 13, 2008 and Circular 11/2006/TT-BTC, the below Fee Schedule has been effective from June 13, 2008:

<table>
<thead>
<tr>
<th>Fee Type</th>
<th>Fee Level (in VND)</th>
<th>Note</th>
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<tbody>
<tr>
<td>Terminal Utilisation Fee</td>
<td>20,000,000,000/terminal/p.a.</td>
<td>The terminal used by the dealer on each trading floor</td>
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<tr>
<td>Transaction Fees</td>
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<td></td>
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<tr>
<td>Shares, Fund Certificates</td>
<td>0.03%/transaction amount</td>
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<tr>
<td>Bonds</td>
<td>0.0075%/transaction amount</td>
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<tr>
<td>Annual Listing Management Fee</td>
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<td>Listing Value &lt; VND 10 Bio.</td>
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<td>Listing Value &gt; VND10Bio&lt;VND50 Bio</td>
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<td>Listing Value &gt; VND100 Bio</td>
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<td>Custody Fees</td>
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<tr>
<td>Securities Custody</td>
<td>VND2/lot/month</td>
<td>Lot: 10 securities</td>
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<tr>
<td>Securities Transfer</td>
<td>VND 5/lot.</td>
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<table>
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<th>Classifications</th>
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<td>Exchange Fee</td>
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<tr>
<td>Depository Fee</td>
<td>VND 2/lot/month</td>
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<td>Broker Fee</td>
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<td>Transaction Fee (Listed and UPCoM)</td>
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<td>Transaction Fee (Bond Repo)</td>
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<td>UP to 2 weeks</td>
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<td>Over 2 weeks</td>
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<td>Transfer Fee (for both transactions and change of custodian)*</td>
<td>VND 5/lot (max VND 500,000 per transfer)</td>
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<tr>
<td>Trade Error Correction Fee (paid by error party)</td>
<td>VND 500,000 per transactions</td>
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<tr>
<td>Ownership Transfer Fee on off-exchange transactions for listed securities</td>
<td>0.1%</td>
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* Previously, transfer upon a custodian change is free.

Stamp Duty: There is no stamp duty.

Registration Costs: There are no registration costs.
### Market size / statistics

#### A. Market Statistics


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<th>Date</th>
<th>Govt (in USD Billions)</th>
<th>Corp (in USD Billions)</th>
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VIII. Presence of an Islamic Finance (Islamic bond (Sukuk)) market

No Islamic Finance market in VN.
IX. History of Debt Market development

To be added later.
X. Next Step — Future Direction

A. Future Direction

To be added later.

B. G-30 Compliance\(^2\)

<table>
<thead>
<tr>
<th>Recommendation</th>
<th>Implemented</th>
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<tbody>
<tr>
<td>1 Eliminate paper and automate communication, data capture, and enrichment</td>
<td>No</td>
</tr>
<tr>
<td>2 Harmonize messaging standards and communication protocols</td>
<td>No</td>
</tr>
<tr>
<td>3 Develop and implement reference data standards</td>
<td>No</td>
</tr>
<tr>
<td>4 Synchronize timing between different clearing and settlement systems and</td>
<td>No</td>
</tr>
<tr>
<td>associated payment and foreign exchange systems</td>
<td></td>
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<tr>
<td>5 Automate and standardize institutional trade matching</td>
<td>Yes</td>
</tr>
<tr>
<td>6 Expand the use of central counterparties</td>
<td>No</td>
</tr>
<tr>
<td>7 Permit securities lending and borrowing to expedite settlement</td>
<td>No</td>
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<tr>
<td>8 Automate and standardize asset servicing processes, including corporate</td>
<td>Corporate actions standardization:</td>
</tr>
<tr>
<td>actions, tax relief arrangements, and restrictions on foreign ownership</td>
<td>Yes</td>
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<td>9 Ensure the financial integrity of providers of clearing and settlement services</td>
<td>Yes</td>
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<tr>
<td>10 Reinforce the risk management practices of users of clearing and settlement</td>
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<tr>
<td>11 Ensure final, Simultaneous transfer and availability of assets</td>
<td>Yes</td>
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<tr>
<td>12 Ensure effective business continuity and disaster recovery planning</td>
<td>No</td>
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<tr>
<td>13 Address the possibility of failure of a systematically important institution</td>
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<tr>
<td>14 Strengthen assessment of the enforceability of contracts</td>
<td>Yes</td>
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<tr>
<td>15 Advance legal certainty over rights to securities, cash, or collateral</td>
<td>Yes</td>
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<tr>
<td>16 Recognize and support improved valuation methodologies and closeout netting</td>
<td>Yes</td>
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<tr>
<td>arrangements</td>
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<td>17 Ensure appointment of appropriately experienced and senior board members</td>
<td>Yes</td>
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<td>(of the boards of securities clearing and settlement infrastructure providers)</td>
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<td>18 Promote fair access to securities clearing and settlement networks</td>
<td>Yes</td>
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<td>19 Ensure equitable and effective attention to stakeholder interests</td>
<td>Yes</td>
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<tr>
<td>20 Encourage consistent regulation and oversight of securities</td>
<td>Yes</td>
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<td>clearing and settlement service providers</td>
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</table>

\(^2\) The G30 recommendations are taken from the Group of Thirty’s report Global Clearing and Settlement – A plan of action (Copyright © 2003 Group of Thirty) [http://www.partad.ru/wrld/word/g30app1.pdf](http://www.partad.ru/wrld/word/g30app1.pdf)
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<tr>
<th>Potential barrier area</th>
<th>Current situation</th>
<th>Market Assessment Questionnaire scores</th>
<th>Overall barrier assessment</th>
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<tbody>
<tr>
<td>Quotas</td>
<td>There are foreign ownership limits on equities but not on bonds, unless the issuer chooses to set a limit. The market is generally viewed as open to foreign investors.</td>
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<tr>
<td>Investor registration</td>
<td>Foreign investors need to obtain a trading code. This is granted within 1-2 weeks of validly completed applications. The documentation requirements were previously onerous (requiring consularisation of documents) and requirements for certain types of entities were not clear. However, the requirements have been simplified under new regulations issued in December 2008.</td>
<td>LOW</td>
<td>LOW</td>
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<tr>
<td>FX controls - conversion</td>
<td>Foreign investors are allowed to convert FCY to VND in order to trade on the Hanoi and Ho Chi Minh exchanges. The rate must be within a fixed margin of ±5% of the official exchange rate fixed by the SBV on a daily basis (previously 3%). Foreign investors are only able to execute FX transactions for same-day, next day, or spot value. FCY forwards cannot be sold to foreign investors. Third-party FX is possible, but uncommon. There are no clearly defined procedures or documentation requirements, and as a single payment system does not exist, third-party FX may be problematic.</td>
<td>LOW</td>
<td>LOW</td>
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<tr>
<td>FX controls - repatriation of funds</td>
<td>Sales proceeds, dividends and interest may be freely repatriated, subject to tax certification. However, the FX market can be highly illiquid. This is of major concern to investors. &quot;Because VND constantly trades at upper end of trading band, FX requests are placed in a queue that may take ages to be considered.&quot; &quot;The way that capital controls work in Vietnam also causes problems - last year, the rate bands were not adjusted and the central bank would not sell USD at the unadjusted rates, so the market dried up.&quot; It is not so much the regulations, but market liquidity, due to the narrow rate bands, that causes the problems. The wider 5% band may improve the situation.</td>
<td>LOW</td>
<td>HIGH</td>
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<tr>
<td>Cash controls - credit balances</td>
<td>There are no restrictions on foreign investors maintaining credit balances in VND, or in investing surplus cash balances in interest-bearing accounts or money market instruments.</td>
<td>OK</td>
<td>OK</td>
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<tr>
<td>Cash controls - overdrafts</td>
<td>Foreign investors are not allowed to overdraw their cash accounts. Pre-funding is required for all securities trades. Securities companies only accept its customers order if they have enough securities and money in their account. This regulation is intended to prevent the possibility of default.</td>
<td>HIGH</td>
<td>HIGH</td>
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<tr>
<td>Taxes</td>
<td>Foreign investors are taxed at the rate of 0.1% on the gross proceeds of all sale transactions of taxable bonds (i.e. principal as well as gain). Interest income received from taxable bonds is subject to a tax of 0.1% calculated on the par value (i.e. the principal amount of the bond) plus the interest amount. Effectively, all bonds are taxable.</td>
<td>HIGH</td>
<td>HIGH</td>
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<tr>
<td>Potential barrier area</td>
<td>Current situation</td>
<td>Market Assessment Questionnaire scores</td>
<td>Overall barrier assessment</td>
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<tr>
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<tr>
<td>Potential barrier area</td>
<td>While 0.1% is relatively small, the fact that it is applied to the principal on sale of bonds discourages trading. Investors view the tax system as being complex, but this may reflect the unfamiliar rules rather than inherent complexity. There is no provision for relief at source or for reclaims.</td>
<td></td>
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<tr>
<td>Omnibus accounts</td>
<td>Omnibus accounts are allowed. Global custodians and ICSDs can operate omnibus accounts provided the custodian / ICSD registers as an investor. However, there is no nominee concept in Vietnamese law.</td>
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<tr>
<td>Settlement cycle</td>
<td>The settlement cycle for bonds is T+1. Market participants have commented that it is possible for trades to be repudiated as, in law, a trade is not valid until it has been input into the Hanoi exchange system.</td>
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<td>Message formats</td>
<td>SWIFT message formats are not currently used by the CSD or by local market participants.</td>
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<tr>
<td>Securities numbering</td>
<td>ISIN codes are not currently used by the CSD or by local market participants. VSD is in the process of allocating ISIN codes for Vietnamese securities. However, ISIN codes are not available until the bonds are registered at VSD.</td>
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<td>HIGH</td>
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<td>Matching</td>
<td>There is a trade matching system but not a settlement matching system for bonds.</td>
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<td>Dematerialisation</td>
<td>All bonds are now issued in dematerialised form. Existing issues must be deposited into the VSD (and dematerialised) if they are to be traded.</td>
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<tr>
<td>Regulatory framework</td>
<td>Regulations may be unclear. Different market intermediaries may interpret regulations differently. However, overall, the market is consistently moving towards international standards.</td>
<td>-</td>
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</table>
Contributors and references:

- Market Profile provided by Citi
- Deutsche Bank Domestic Custody Services, Market Guide Vietnam, July 2009
- 2010 – THE GUIDE TO CUSTODY IN WORLD MARKETS by State Street
- Annual Report 2010 Hanoi Stock Exchange
- Allen Arthur Robinson – Vietnam Laws
- asianbondsonline.adb.org

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Mobile: +81-(0)80-3360-7551
E-Mail: shige.inukai@river.dti.ne.jp
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I. High Level Structure, Type & Characteristics of the Market

A. Overview

Hong Kong, China has one of the most open local currency bond markets in Asia. This is reflected in the large variety of local and offshore issuers who benefit from a sophisticated infrastructure and well-developed market institutions. There is a large investor base and wide acceptance of product types.

Public sector bonds come in the form of Exchange Fund Bills and Notes (EFBNs), which are issued and managed by the Hong Kong Monetary Authority (HKMA).

The Central Moneymarkets Unit (CMU) was set up primarily to provide computerized clearing and settlement facilities for Exchange Fund Bills and Notes. In December 1993, the Hong Kong Monetary Authority (HKMA) extended the service to other Hong Kong dollar debt securities.

Since December 1994, the CMU has been linked to international clearing systems such as Euroclear and Cedel. This has helped to promote Hong Kong dollar debt securities to overseas issuers and investors who can make use of these links to participate in the Hong Kong dollar debt market.

In December 1996, an interface between the CMU and the Real-Time Gross Settlement (RTGS) interbank payment system was established. This enables the CMU system to provide its members with real-time and end-of-day delivery versus payment (DvP) services.

In Hong Kong, bonds may be held within the CMU Service operated by the Hong Kong Monetary Authority ("HKMA") in either definitive or global instrument form. The CMU Service provides a central depository service for CMU Instruments held within the CMU Service and an electronic book-entry system for electronic trading between CMU Members of CMU Instruments without physical delivery of CMU Instruments.

The bond instruments must be lodged with a sub-custodian appointed by the HKMA. The bond issuer must either be a CMU Member or authorise a CMU Member as a Lodging Agent in order to use the depository services of the CMU Service.

CMU represents 99.9% of bond trades in market.

EFBNs provide benchmark yields that guide private debt pricing. 80% of the bonds issued and traded are private sector issuances.

Bond trading is mostly through over-the-counter (OTC) markets. However, some bonds are traded on the Securities Market of the Hong Kong Stock Exchanges and Clearing (HKEx), which is the holding company that operates the stock exchange. In addition, three-year Exchange Fund Note (EFN) futures are traded on the HKEx Derivatives Market.

Hong Kong, China is the preferred location in Asia for bond issues by foreign and domestic corporations—as well as supranational borrowers—because of its easy access to international debt markets.

A wide range of asset classes are available for securitization.
The two main asset classes securitized are i) residential and commercial mortgages, and ii) HKMA claims on central governments and central banks.

HKMA established the Hong Kong Mortgage Corporation (HKMC) and Hong Kong Link 2004 to facilitate securitization of residential mortgages and toll facilities, respectively.

To promote the development of the local debt market, authorities have introduced a number of new products, expanded and improved market infrastructure, and provided a tax and regulatory environment conducive to market development.

B. Types of Bonds

1. By issuer category
   a. Bonds issued by public entities
      i. Government bonds
      ii. Exchange fund papers (notes) issued by the HKMA
         The programmed for Exchange Fund Notes (EFN) commenced in 1993. The EFNs are Hong Kong dollar fixed income debt securities issued by the Hong Kong Special Administrative Region Government (HKSAR) for the account of the Exchange Fund. The EFNs are traded in lot size of HKD $ 50,000 (i.e. 500 units of HKD $ 100 each). The EFNs are of various maturities 2-years, 3-years, 5-years, 7-years and 10-years
      iii. Statutory bodies
      iv. Government-related corporations
   b. Bonds issued by private entities
      i. Authorized institutions
      ii. Local corporates
      iii. Multilateral development banks (MDB)
      iv. Non-MDB overseas borrowers

2. By type of bonds
   a. Straight Bonds (Government Bonds / Corporate Bonds)

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1 e.g. Hong Kong Airport Authority and Hong Kong Housing Authority
2 e.g. Bauhinia Mortgage-backed Securities Limited, Hong Kong Mortgage Corporation, Hong Kong Link 2004 Limited, the Kowloon-Canton Railway Corporation, and the MTR Corporation Limited
3 Authorized institution means a bank, a restricted licence bank or a deposit-taking company as defined in Section 2 of the Banking Ordinance.
4 Multilateral development bank (MDB) refers to the Asian Development Bank, the Council of Europe Social Development Fund, the European Company for the Financing of Railroad Rolling Stock, the European Investment Bank, the European Bank for Reconstruction and Development, the Inter-American Development Bank, the International Bank for Reconstruction and Development, the International Finance Corporation, the African Development Bank, and the Nordic Investment Bank.
b. Floating Rate notes

c. Corridor notes

d. Index-linked Bonds

e. Loan stocks

f. Exchange Fund Notes

Most of the debt instruments other than government bonds and some corporate bonds are issued in bearer form and held physically. All government bonds and some corporate bonds are eligible for clearing at the Central Money-markets Unit Service (CMU) and maintained in book-entry form.

3. Money Markets instruments

The Hong Kong Monetary Authority (HKMA) is responsible for issuance of money market instruments in Hong Kong. Some of the instruments issued by HKMA are as listed below:

a. Certificate of Deposit

b. Commercial Paper

c. Exchange Fund Bills

The Exchange Fund Bills programme was introduced in March 1990. Bills of 91 days, 182 days and 364 days are issued under this program. The Exchange Fund notes and bills are listed by the HKMA on the SEHK and are available for trading to retail investors. The notes and bills provide a sound interest rate yield benchmark to the market.

4. By listing status

Listed bonds and unlisted bonds; the latter typically retail bonds publicly available. HK Government would never list its bonds. Recent RMB bonds are unlisted, for professional investors only. When considered listing, cost/benefit trade off (fees vs. visibility) may exist for issuer; fund managers may appreciate access to official pricing but can also determine realistic price through modelling.

a. Bonds can be listed and traded on the Hong Kong Stock Exchange

Only 2 bonds actively traded in HKEx; HKEx fees considered expensive. Exchange listing of some bonds probably due to separate requirements for mutual funds/unit trust to only buy listed bonds.

b. Bonds (Tap Issue) / DEBT ISSUANCE PROGRAMMES\(^5\) listed but can be traded over-the-counter (OTC)

c. SELECTIVELY MARKETED SECURITIES status listing (Chapter 37)

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\(^5\) Issues of debt securities where only part of the maximum programmes’ principal amount or aggregate number of securities under the issue is issued initially and a further tranche or tranches may be issued subsequently.
SELECTIVELY MARKETED SECURITIES means that debt securities marketed to or placed with any number of registered dealers or financial institutions either with a view to their reselling such securities as principals off-market, nearly all of which, because of their nature, will normally be purchased and traded by a limited number of investors who are particularly knowledgeable in investment matters or placing such securities with a limited number of such investors and “selective marketing” shall be construed accordingly.

d. Bonds non-listed, can be traded over-the-counter (OTC)

The issuer may choose to issue listed bonds by making a listing application to the Hong Kong Stock Exchange ("HKSE") for the listing of and permission to deal in the bonds on the HKSE, and satisfy certain qualifications for listing as stated in chapters 23 to 26 of the Listing Rules.

Issuers having debt securities listed or seeking to list debt securities on the HKSE must comply with the requirements set out in the Listing Rules as promulgated by the HKSE. (Chapter 29) (Chapter 36 for OVERSEAS ISSUERS OTHER THAN SELECTIVELY MARKETED ISSUERS)


Chapter 37 sets out the requirements for the listing on the Exchange of selectively marketed securities for SELECTIVELY MARKETED ISSUERS.

Most of the bonds in Hong Kong domestic market are traded OTC.

In most cases the purpose of Bonds / DEBT ISSUANCE PROGRAMMES listing on the Hong Kong Stock Exchange are just for (1) profiling purpose, (2) for regulatory and (3) price discovery purposes.

HKEx listed bonds include Exchange Fund issues.

5. By note forms

a. Bonds may be in bearer form or registered form, represented by definitive or global notes.

b. The most common form of bonds is global notes, which represent the whole issue and are generally deposited with the CMU Service in the name of the

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6 In Hong Kong, bonds may be held within the CMU Service operated by the Hong Kong Monetary Authority ("HKMA") in either definitive or global instrument form. The CMU Service provides a central depository service for CMU Instruments held within the CMU Service and an electronic book-entry system for electronic trading between CMU Members of CMU Instruments without physical delivery of CMU Instruments.

The bond instruments must be lodged with a sub-custodian appointed by the HKMA. The bond issuer must either be a CMU Member or authorise a CMU Member as a Lodging Agent in order to use the depository services of the CMU Service.

While the bonds are represented by global notes, the CMU Lodging Agent holds the legal title of these bonds, which are then "immobilised" via the CMU accounts. The holders of the CMU accounts hold the bonds in the "Main Account" for the benefit of themselves, and the bonds in the General/Specific Custody Accounts for and on behalf of their own customers. For the bonds held in the General/Specific Custody Accounts, the CMU Members would have to refer to their own internal records to ascertain the beneficial ownership of the bonds held in such accounts. The Issuer and the Paying Agent directly make payments of principal, interest or any amounts to the persons for whose accounts interests in the global bond are credited (as set out in a CMU Instrument Position Report, or as notified to the CMU Lodging Agent by the CMU Service).
CMU Lodging Agent for safekeeping.

c. Bearer or registered securities evident; bearer certs need to be submitted to CMU lodging agent (participant); lodging agent tends to be fiscal agent, and custodian.

d. Proposal for dematerialisation by 2013, but requires change to Company Ordinance.

6. By structure of bond issue – Fiscal agent or Trustee

There are generally two structures for bond issues: the fiscal agent structure or the trustee structure.
The rights and obligations of the bondholders and the issuer are different depending on the structure.

Trustee possible, but not required; trustee vs fiscal agent as alternative = 10 to 90%; typically question of cost, and limited trustees in the market; however, issuer may appreciate central party to handle matters.

No recent issues or programmes featured trustee. Trustee provisions under HK law were out-dated, in comparison with English Trustee Act (2000).

a. Fiscal agent structure:

v. A fiscal agency agreement is executed between the issuer and the fiscal agent (as the principal paying agent of the issuer).
The issuer pays the interest or the principal to the fiscal agent and the fiscal agent instructs the other paying agents to pay the amounts of interest or principal to the bondholders. The fiscal agent then reimburses the paying agents the amounts paid out.

vi. The fiscal agent also has other functions, e.g. keeping records of payments on the bonds, calling and holding bondholders’ meetings when necessary, sending notices to bondholders and issuing replacements for lost or destroyed bonds.

vii. As the fiscal agent is the agent of the issuer, it does not represent the interests of the bondholders.

viii. The issuer would generally execute a ‘deed of covenant’ under which bondholders are given direct rights of enforcement against the issuer (for default in payment or delivery of definitive bonds).

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individual beneficial holders will have to rely on the CMU Member or the CMU Lodging Agent for the delivery of payments and notices to them.

On certain bond issues, a temporary global note is produced where a 40-day lock-up period is required under US tax and securities laws (Regulation S of the Securities Act 1933), during which interest in the securities cannot be traded or paid. After the 40-day period, the temporary global note may be exchanged for a permanent global note (which may be conditional upon the CMU Service having received certification as to the non-US beneficial ownership of the CMU Instruments for compliance with Regulation S).
The permanent global note may be exchanged into definitive notes in limited circumstances (e.g. the closure of the clearing systems or events of default of the issuer or guarantor).
The CMU Service has linkages with other clearing systems. An investor holding an interest through an account with either Euroclear or Clearstream in any CMU Instruments held in the CMU Service will hold that interest through the respective accounts which Euroclear and Clearstream each have with the CMU Service.

7 Definition: Arrangement under which a party promises to pay a certain sum regularly to another party within a specified timeframe.
ix. An example is the Swire Pacific MTN Financing Limited and Swire Properties Offshore Financing limited US$3,500,000,000 MTN Programme dated 18 October 2010.

b. Trustee structure: (Trustee not required)

i. The bonds may be constituted in a ‘trust deed’, under which the issuer covenants with the trustee to perform its duties under the terms and conditions of the bonds, including to pay any amounts due under the bonds and to notify the trustee of any event of default.

ii. The trustee is the representative of the bondholders and exercises the bondholders’ rights on behalf of the bondholders and monitors the performance by the issuer of its obligations under the bonds.

iii. A paying agency agreement is executed between the issuer, the trustee and the paying agent under which the paying agent (as agent for the issuer) receives payments due to the bondholders from the issuer and pays the relevant interest or principal to the bondholders.

iv. Although, in practice, payments to the bondholders are effected through the paying agents, the trust deed usually provides power to the trustee, if it declares that an event of default has occurred, to require the issuer to make payments directly to it rather than to the paying agent, or to require the paying agent to act as the trustee’s agent, rather than the issuer’s agent, when making payments.

v. This protects the bondholders where the issuer is insolvent; the money held by the paying agent would belong to the trustee, rather than being vulnerable to claims by the issuer or the issuer’s liquidators.

vi. An example is the MTR Corporation Limited US$3,000,000,000 Debt Issuance Programme dated 16 November 2010.

C. Methods of Issuing Bonds

1. Government bonds

   Government bonds are issued by competitive tender on a bid-price basis. Tenders must be submitted through recognized dealers which are also appointed as primary dealers as announced by the Government from time to time.

   Underwriting arrangements are in place by which recognized dealers which are also appointed as primary dealers may be required to subscribe for bonds which have not otherwise been subscribed pursuant to valid tenders.


2. Exchange fund papers (bills / notes) issued by the HKMA

   Exchange fund bills are issued by competitive tender on a bid-yield basis, whereas
exchange fund notes are issued by either competitive tender on a bid-price basis or
by non-competitive tender.

The tender and underwriting arrangements are similar to those applicable to
Government Bond Programme.

For details, refer to the Information Memoranda of Exchange Fund Bills and Notes

3. Bonds issued by other statutory bodies and government-owned corporations

Methods are similar to those of issuing corporate bonds stated below.

4. Methods of issuing Corporate Bonds

Private entities generally adopt one of the following methods to issue corporate
bonds:

a. Public offer for bonds intended to sell to the public; or

b. Private placement for bonds intended to sell to a small group of investors.

c. There are some differences in the requirements for the two methods.
For instance, a more comprehensive and detailed prospectus is often required
for public offer whereas a relatively simple form of offer document or term sheet
suffices for private placement.
For details, refer to Section 38 of the Companies Ordinance

d. For bonds to be listed on the Hong Kong Stock Exchange, corporates should
also observe the requirements, among others, set out in Section 44B of the

D. Credit-Rating Agencies and Credit Rating of Bonds

There are no credit rating agencies (CRAs) based exclusively in Hong Kong.
However, the three largest CRAs have offices in this jurisdiction, alongside several
smaller multinational CRAs.

In view of the revised Code of Conduct Fundamentals for Credit Rating Agencies issued
by the International Organization of Securities Commissions in May 2008 and the
Declaration on Strengthening the Financial System made by G20 on 2 April 2009, the
Securities and Futures Commission (SFC) is proposing to introduce a regulatory
framework to strengthen its oversight of CRAs.

Refer to the Consultation Paper and Consultation Conclusions Concerning the
Regulatory Oversight of Credit Rating Agencies published at SFC’s website

E. Bond Related Systems for Investor Protections

1. Issue authorization for unlisted bonds:

    Bond issues should obtain SFC’s authorization for issuance of unlisted bonds which
are regarded as structured investment products (such as equity linked or credit-linked bonds as defined in the Code on Unlisted Structured Investment Products issued by the SFC) and are intended to be sold to the public.

2. Cooling-off or unwind right against unlisted bonds:

Issuers should also confer on investors a cooling-off or unwind right in respect of the structured investment product purchased, whereby investors may cancel their orders, sell the product back to the issuer or its agent, or otherwise unwind the transaction and receive a refund or payment calculated based on the principles set out in the code.


F. Governing laws of bond issuance

Unless otherwise specified in the prospectus, offer document or term sheet etc, in most cases the issuance of bonds in Hong Kong is governed by and construed in accordance with the laws of Hong Kong.

Specific laws governing different types of bonds are summarised as follows:

1. Government bonds:

   The issuance of Government bonds is governed by the Loans Ordinance (Chapter 61 of the Laws of Hong Kong).
   On 8 July 2009, the Legislative Council passed a resolution under Section 3 of the Loans Ordinance authorizing the Government to borrow up to a maximum principal amount outstanding at any time of HK$100 billion or equivalent under the Government Bond Programme.

2. Exchange fund bills / notes issued by the HKMA

   Exchange fund bills / notes are issued for the account of the Exchange Fund under the Exchange Funds Ordinance (Chapter 66 of the Laws of Hong Kong).

   a. Bonds issued by other statutory bodies and government-related corporations

      Issuance of bonds is governed by the respective ordinances governing the statutory bodies and/or Companies Ordinance where applicable.
      For instance, bonds issued by the Airport Authority, which is a statutory body established under the Airport Authority Ordinance (Chapter 483 of the Laws of Hong Kong), are governed by the same ordinance.

   b. Bonds issued by private entities

      Issuance of bonds is governed by, among others, Sections 41, 44A, 44B and 48A

If the bonds are to be listed on the Hong Kong Stock Exchange, issuers have to observe the Listing Rules as mentioned above and other relevant rules promulgated by the Hong Kong Stock Exchange.

If participants use the clearing, settlement and custody services provided by the Central Money markets Unit (CMU), the debt securities settlement system operated by the HKMA, they should observe the relevant rules promulgated by the HKMA.

G. Transfers of interests in bonds

Transfer of title can be evidenced through registration.

1. Transfer of entitlement and ownership of securities

The bondholders should send, whether directly or indirectly, transfer notices to the CMU Member or the CMU Lodging Agent to send the transfer instructions to the CMU Service.

The transfer of ownership becomes effective, upon matching a debit instruction with the corresponding credit instruction and registration in the book-entries in the securities accounts of the CMU Members within the CMU Service.

2. Entitlement perfection against the third party / Finality of transactions

a. Real-time securities transfer transactions on the CMU Members’ Terminal /SWIFT are immediately completed and final (not subject to waiting time).

b. End-of-day securities transfer transactions are balanced during CMU end-of-day settlement processing.

c. Notwithstanding the mode/means of transfer, all local securities transfer instructions affected through the CMU Service shall be settled by the HKMA debiting or crediting the relevant securities accounts of the CMU Members concerned, and once debited or credited to such securities accounts; such securities transfer instructions shall be deemed made, completed, irrevocable and final.

d. The situation can be more complex where the securities transfer instructions are effected through linkages with other national settlement systems or with Clearstream or Euroclear.

e. It is also worth noting that the finality of the transactions settled through the CMU system is protected from insolvency laws (including liquidators and receivers) under section 19 of the Clearing and Settlement Systems Ordinance (Cap 584).

For example, the securities transactions, once settled, may not be set aside on grounds of unfair preference.

f. Prohibited transfers

i. On-Exchange naked short selling of listed securities is prohibited in Hong Kong, and all CMU Members must undertake not to incur a short position in
any of the CMU Instruments. Securities may only be sold at or through a recognised stock market if the seller (as principal) or his principal (himself as agent) has, or has reasonable grounds for believing that he or the principal has, a presently exercisable and unconditional right to vest the securities in the purchaser (section 170 of the SFO).

ii. The concept of “presently exercisable and unconditional right to vest the securities in the purchaser” is interpreted with some flexibility (See the SFC’s Guidance on Short Selling Reporting and Stock Lending Record Keeping Requirements available at http://www.sfc.hk/sfcRegulatoryHandbook/EN/displayFileArchServlet?docno=H141 for further illustration).

iii. On-Exchange covered short sales (i.e., short selling orders) in “designated securities” (as designated by the HKSE pursuant to the Short Selling Regulations in the Eleventh Schedule to the Listing Rules) are permitted provided that

(1) the seller (whether acting as principal or agent) must, at the time of placing a short selling order, identify it as a short selling order and provide documentary assurance that the sale is “covered” and

(2) An intermediary who receives a short selling order must ensure that he has obtained a documentary assurance that the sale is “covered”.

iv. The maximum penalties for contravention of section 170 of the SFO are a fine of HK$100,000 and imprisonment for 2 years.

v. The Hong Kong Securities Clearing Company Limited (HKSCC) charges a default fee of 0.50% of the market value of failed transactions.

H. Definition of securities

At first, as far as the legal definition of debt instruments are concerned, for bonds to be listed on the Hong Kong Stock Exchange or cleared through the CMU, they must satisfy the criteria as set out in, among others, the Listing Rules (http://www.hkex.com.hk/eng/rulesreg/listrules/mbrules/vol1_4.htm) and CMU Service Reference Manual (which is accessible by CMU members only) respectively. Also, definition of securities laid down in Securities & Futures Ordinance (SFO), governed by Financial Services Commission (FSC).

1. Definition of “CMU Instruments” in the CMU Service Reference Manual

   a. CMU Instruments

      CMU Instruments are securities or capital markets instruments which are specified in the CMU Service Reference Manual as capable of being held within the CMU Service.

   b. CMU Instruments include:

      i. Asset Backed Securities
ii. Equity Linked Instrument

iii. Fixed Rate Certificate of Deposit

iv. Government Bond

v. Floating Rate Certificate of Deposit

vi. Bonds

vii. Fixed Rate Notes

eviii. Floating Rate Notes

ix. Commercial Papers

x. Mortgage-backed Securities

xi. Fixed Rate Linked Securities

xii. Floating Rate Linked Securities

xiii. Zero Coupon Certificate of Deposit

xiv. Zero Coupon Notes

xv. Bills of Exchange other than trade bills

2. Definition of “securities” in the SFO and the Listing Rules

a. Section 1 of Part 1 of Schedule 1 to the Securities and Futures Ordinance (“SFO”)

"Securities" means -

i. shares, stocks, debentures, loan stocks, funds, bonds or notes of, or issued by, a body, whether incorporated or unincorporated, or a government or municipal government authority;

ii. rights, options or interests (whether described as units or otherwise) in, or in respect of, such shares, stocks, debentures, loan stocks, funds, bonds or notes;

iii. certificates of interest or participation in, temporary or interim certificates for, receipts for, or warrants to subscribe for or purchase, such shares, stocks, debentures, loan stocks, funds, bonds or notes;

iv. interests in any collective investment scheme;

v. interests, rights or property, whether in the form of an instrument or otherwise, commonly known as securities;

vi. interests, rights or property which is interests, rights or property, or is of a class or description of interests, rights or property, prescribed by notice
under section 392 of this Ordinance as being regarded as securities in accordance with the terms of the notice;

vii. a structured product that does not come within any of the paragraphs (i) to (vi) but in respect of which the issue of any advertisement, invitation or document that is or contains an invitation to the public to do any act referred to in section 103(1) (a) of this Ordinance is authorised or required to be authorised, under section 105(1) of this Ordinance,

But does not include-

(1) Shares or debentures of a company that is a private company within the meaning of section 29 of the Companies Ordinance (Cap 32);

(2) Any interest in any collective investment scheme that is-

(A) a registered scheme as defined in section 2(1) of the Mandatory Provident Fund Schemes Ordinance (Cap 485), or its constituent fund as defined in section 2 of the Mandatory Provident Fund Schemes (General) Regulation (Cap 485 sub. leg. A);

(B) An occupational retirement scheme as defined in section 2(1) of the Occupational Retirement Schemes Ordinance (Cap 426); or

(C) a contract of insurance in relation to any class of insurance business specified in the First Schedule to the Insurance Companies Ordinance (Cap 41);

(3) any interest arising under a general partnership agreement or proposed general partnership agreement unless the agreement or proposed agreement relates to an undertaking, scheme, enterprise or investment contract promoted by or on behalf of a person whose ordinary business is or includes the promotion of similar undertakings, schemes, enterprises or investment contracts (whether or not that person is, or is to become, a party to the agreement or proposed agreement);

(4) Any negotiable receipt or other negotiable certificate or document evidencing the deposit of a sum of money, or any rights or interest arising under the receipt, certificate or document;

(5) any bill of exchange within the meaning of section 3 of the Bills of Exchange Ordinance (Cap 19) and any promissory note within the meaning of section 89 of that Ordinance;

(6) any debenture that specifically provides that it is not negotiable or transferable (excluding a debenture that is a structured product in respect of which the issue of any advertisement, invitation or document that is or contains an invitation to the public to do any act referred to in section 103(1) (a) of this Ordinance is authorised, or required to be authorised, under section 105(1) of this Ordinance);

(7) interests, rights or property which is interests, rights or property, or is of a class or description of interests, rights or property, prescribed by notice under section 392 of this Ordinance as not being regarded as securities
in accordance with the terms of the notice;

b. Section 7 of Part 1 of Schedule 1 to the SFO

References to securities of a corporation

In this Ordinance, a reference to securities (however described) as those of a corporation shall, unless the context otherwise requires, be construed as a reference to securities (having the applicable meaning, whether under section 1 or otherwise) which are-

i. issued, made available or granted by the corporation;

ii. proposed to be issued, made available or granted by the corporation; or

iii. Proposed to be issued, made available or granted by the corporation when it is incorporated.

c. Listing Rules

i. “Debt securities” means debenture or loan stock, debentures, bonds, notes and other securities or instruments acknowledging, evidencing or creating indebtedness, whether secured or unsecured and options, warrants or similar rights to subscribe or purchase any of the foregoing and convertible debt securities.

ii. “Equity securities” means shares (including preference shares and depositary receipts), convertible equity securities and options, warrants or similar rights to subscribe or purchase shares or convertible equity securities, but excluding interests in a Collective Investment Scheme.

I. Self-governing rules behind the market

Not applicable in Hong Kong context.

J. Bankruptcy procedures

Any bond issuers going bankruptcy are subject to the relevant rules set out in the Bankruptcy Ordinance (Chapter 6 of the Laws of Hong Kong).

The ranking of a bond vis-à-vis other indebtedness of the bond issuer is determined taking into account the terms and conditions set out in the prospectus, offer documents, term sheets or similar form of documents as well as Section 38 (Priority of debts) of the Bankruptcy Ordinance.

K. Meetings of bondholders

1. Resolution of a meeting of bondholders

The terms as to the rights to convene meetings of bondholders and quorum requirements may be stated in the trust deed or the fiscal agency agreement and depend on agreement of the parties.

a. Fiscal agent structure
i. The Issuer or noteholders holding not less than 10% in nominal amount of the bonds for the time being outstanding may convene a meeting of noteholders.

ii. The quorum is one or more persons holding or representing not less than 50% in nominal amount of the notes for the time being outstanding.

iii. (e.g. Swire Pacific MTN Financing Limited and Swire Properties Offshore Financing Limited US$3,500,000,000 MTN Programme dated 18 October 2010)

b. Trustee structure

i. Noteholders holding not less than 10% in principal amount of the notes for the time being outstanding may convene a meeting of noteholders.

ii. The quorum is two or more persons holding a clear majority in principal amount of the notes for the time being outstanding (except where the business of the meeting covers certain “reserved matters” a higher threshold is required).

iii. (Standard Chartered PLC/ Standard Chartered Bank/ Standard Chartered Bank (Hong Kong) Limited / Standard Chartered First Bank Korea Limited US$35,000,000,000 Debt Issuance Programme dated 10 November 2010)

iv. Resolutions passed in a meeting of bondholders, or simply written resolutions of holders holding a specified per cent of aggregate principal amount of outstanding bonds would be binding on all holders of the bonds.

v. Usually any changes to the terms would have to be agreed to by the Issuer. Practically speaking bondholders’ meetings are generally only convened by the Issuer.

2. Appointment of a trustee

There is no mandatory requirement for the appointment of a trustee to represent the interests of bondholders in Hong Kong.

The most common structure for bond issues is the fiscal agent structure with the issuing cost consideration for the issuers.

And the ways in which bondholders are protected and their interests are represented are discussed above.

L. Event of default

1. Terms of events of default

a. Events of default are a matter of negotiation but, generally, cover non-payment of principal or interest by the Issuer, non-compliance with obligations under the bond instruments, non-payment of other indebtedness of the issuer or guarantor when due; the occurrence of certain specified events, for example, change of control, commencement of proceedings against the Issuer, passing of an effective resolution for the winding up, administration or dissolution of the
issuer or guarantor.

b. Events of default are usually found in the trust deed, fiscal agency agreement or deed of covenant (executed by the issuer and guarantor).

2. Declaration of the default

a. Fiscal agent structure:

The noteholders may give written notice to the Issuer to declare that the notes would become forthwith due and payable. (This direct right is contained in a deed of covenant.)

(Swire Pacific MTN Financing Limited and Swire Properties Offshore Financing limited US$3,500,000,000 MTN Programme dated 18 October 2010)

b. Trustee structure:

The trustee may at its discretion give notice of default by:

i. Declaring the notes immediately due and repayable (with a certified opinion that the event is materially prejudicial to the interests of the holders of the Notes); or

ii. If so directed in writing by the holders of at least 25% in principal amount of the notes, or by an extraordinary resolution of the holders of the notes, declaring all the notes immediately due and repayable.

The trustee may institute proceedings against the issuer to enforce repayment of the principal of the notes with accrued interest and to enforce the provisions of the trust deed. However, the noteholders are not entitled to proceed directly against the issuer unless the trustee fails to do so within a reasonable period and such failure is continuing.

The noteholders’ interests are represented by the trustee.

(MTR Corporation Limited US$3,000,000,000 Debt Issuance Programme dated 16 November 2010)

c. When the default happens:

The default may happen at any time during the day.

d. Precedent of a default of bonds in Honk Kong:

The Lehman Brothers minibonds issued by Pacific International Finance Limited (“Pacific International”) is a recent example of default of (structured) notes (not by the issuer, but by a “reference entity”).

Although not technically a default by the issuer, this is a high profile example of losses suffered by investors in respect of bonds which were credit-linked, where the reference entity became insolvent.

M. Options available on the bond market
1. Currency

The most common currencies in which bonds are denominated are: HKD, RMB, USD and EUR.
The CMU Service is linked to the HK dollar, US dollar, Euro and Renminbi RTGS settlement systems in Hong Kong to provide real time DvP capability for settlement of debt securities denominated in those currencies.

2. Convertible bonds

a. As far as convertible bonds are concerned, the issuer will engage a Conversion Agent, responsible for handling on behalf of the issuer the conversion notices sent by the bondholders, receiving payments from bondholders and the issuer in respect of the conversion and cancelling the original bonds upon conversion.

b. The Conversion Agent would also be responsible for calculating the number and aggregate principal amount of new shares to which the bondholders exercising the conversion rights would be entitled.

c. The Conversion Agent is normally a bank such as Duetsche Bank or Citibank.

3. Retail bonds

a. Retail bonds are usually represented by a single global bond issued in a principal amount equal to the total principal amount of the bonds, which is deposited with a sub-custodian for the CMU Service. The placing banks will hold these bonds in their securities accounts with the CMU Service for and on behalf of individual investors.

b. The CMU Account holders are treated as the bondholders. Interest and principal payments will be made to the CMU Account holders (i.e. the placing banks).

c. Individual investors hold their interests only indirectly in book-entry form through the securities accounts they hold with the placing banks. The individual investors have to rely on the placing banks to ensure payments are credited to their securities or investment accounts with the placing banks.

d. Individual investors also have to rely on the CMU Participants to enforce any rights against the issuer on their behalf.

e. Where the bonds are listed, the bonds may be traded on the Exchange. Where the bonds are not listed, secondary markets may be established between the placing banks.

f. An issue of bonds to the public is required to comply with the prospectus requirements under the Companies Ordinance (Cap.32) (“CO”), including the contents as specified in Third Schedule to the CO, and the offer of investments regime under the Securities and Futures Ordinance (Cap. 571) (“SFO”).

g. Example: Bank of China Limited retail 2.65% / 2.90% RMB Bonds due 2012/2013 dated 7 September 2010 (which adopted the fiscal agent structure).

N. Parties involved in a bond issue and their respective roles
1. Issuer

2. Guarantor

3. Sub-custodian appointed by the HKMA

4. Trustee / Paying Agent / Fiscal Agent:
   a. Responsible for paying interest and principal under, and sending notices pursuant to, the notice provisions of the CMU Instruments.
      i. The CMU Lodging Agent receives an Issue Position Report from the CMU Service on the interest payment dates of the relevant CMU Instruments, the aggregate nominal value of the relevant CMU Instrument held by each CMU Member as at the Interest Payment Record Date, the maturity date of the relevant CMU Instruments, the aggregate nominal value of the relevant CMU Instrument held by each CMU Member as at the Maturity Record Date.
      ii. The persons shown in the CMU accounts as the beneficial holder of the global bonds must look solely to the CMU Lodging Agent / Paying Agent for their share of each payment made by the Issuer.

   b. Responsible for organising and running meetings of bondholders.

5. CMU Member / CMU Lodging Agent
   a. The CMU Member or CMU Lodging Agent holds the legal title of the bonds held within the CMU Service.
   b. Payment of interest: If the CMU Member holds the CMU Instrument for and on behalf of its customers, it should arrange for the relevant amount of interest to be paid to the customers according to the standing arrangements between the CMU Member and the customers.
   c. The CMU Member or CMU Lodging Agent receives the Account Position Report, confirming the balances in their securities accounts with the CMU Service.
   d. CMU Membership is open to all members of the Hong Kong Capital Markets Association\(^8\) and “authorised institutions” under the Banking Ordinance of Hong Kong. All CMU Members are required to sign a CMU Membership Agreement with the CMU Service.

6. Arrangers

\(^8\) Established in 1986, the Hong Kong Capital Markets Association (HKCMA) is an industry association founded by a group of financial institutions active in the Hong Kong market to help promote the development of the local and regional debt capital markets. Since its inception, the HKCMA has performed four main functions:
   i) Providing various professional recommendations and feedback to regulators with respect to developmental issues of the debt markets;
   ii) Providing a forum for market professionals to discuss and implement best practices guidelines;
   iii) Organizing regular functions for market participants to network;
   iv) Providing bond market education and training to the public.

http://www.hkcma.org/
7. Dealers
8. Legal Advisers
9. Auditors
10. CMU Service
11. Participating banks of the respective RTGS settlement systems

O. Major Players in the Market

1. Issuer

The HKMA is the main issuer of Hong Kong-dollar debt instruments, followed by Non-MDB overseas borrowers and authorized institutions.

In 2009, the amount of exchange fund bills issued by the HKMA amounted to HK$1,048 billion, which accounted for 84% of the aggregate amount of Hong Kong-dollar debt instruments issued by any other parties. Such portion was exceptionally high in 2009 due to the reasons set out in our responses to 7.03. In other normal years, the HKMA was still the main issuer and accounted for around 50% of total Hong Kong-dollar debt instruments issued.

As of end 2009, the outstanding amount of bonds issued by public entities including the Government, the HKMA, statutory bodies and government-owned corporations accounted for 55%, and the private entities including authorized institutions, local corporates, MDBs and non-MDB overseas borrowers accounted for the remaining 45%.

In terms of the nationality of issuers (excluding the HKMA), in 2009, 51% were from Hong Kong, followed by Australia (8%), France (7%) and UK (4%).

In terms of the industry of issuers (excluding the HKMA), financial institutions remained the major issuers in the private sector in 2009, and the utilities recorded the highest growth (1,514%) as the base was relatively small in 2008.

2. Investor

The pension funds including the Mandatory Provident Funds, Hong Kong banking institutions and government-related institutions are the major institutional investors of bonds issued in Hong Kong. However, the breakdown of their investment amounts is not available.

Ⅱ. Primary and secondary market regulatory frameworks

A. Hong Kong market Regulatory Structure

1. Market Entry Requirements

There are no market entry requirements or prior registration for foreign clients to enable them to commence trading in the Hong Kong securities market with an exception for the foreign investments in Hong Kong to the Hong Kong Television Broadcast shares to the limit of 10% (per individual shareholder) with an overall aggregate of 49%.

2. Hong Kong Monetary Authority (HKMA)

The Hong Kong Monetary Authority (HKMA) is the apex body that governs the financial sector in Hong Kong. The HKMA was established on April 1, 1993 subsequent to the merger of the offices of exchange and commissioner. It reports to the Financial Secretary.

The HKMA was set-up with the aim of creating a “single authority” responsible to ensure the continuous stability of the monetary and banking sector in Hong Kong. The HKMA also deploys its resources towards development of the local and regional debt markets and the clearing systems in Hong Kong in order to facilitate the cross border transfer of funds and securities.

Following are the policy objectives of the HKMA:

a. Prudent management of the Exchange Fund thus ensuring the stability of the local currency.

b. Regulation of all banking businesses in order to provide safety and stability in the banking system.

c. Future developments of the financial system to further enhance the efficiency and integrity of the current cash payment and settlement system in Hong Kong.

The HKMA solely operates the Central Moneymarkets Unit (CMU) which provides clearing, settlement and depository services for both HKD denominated and international debt securities available for trading in the Hong Kong market. The HKMA has developed external infrastructure linkages with other regional and central depositories in order to settle securities logged with the CMU.

3. Securities and Futures Commission (SFC)

The principal regulator of Hong Kong’s securities and futures markets is the Securities and Futures Commission (SFC), which is an independent statutory body established in 1989 by the Securities and Futures Commission Ordinance (SFCO). The SFCO and nine other securities and futures related ordinances were consolidated into the Securities and Futures Ordinance (SFO), which came into operation on 1 April 2003.

The SFC is responsible for administering the laws governing the securities and futures markets in Hong Kong and facilitating and encouraging the development of these markets.
Its regulatory objectives as set out in the SFO are:

a. to maintain and promote the fairness, efficiency, competitiveness, transparency and orderliness of the securities and futures industry;

b. to promote understanding by the public of the operation and functioning of the securities and futures industry;

c. to provide protection for members of the public investing in or holding financial products;

d. to minimise crime and misconduct in the securities and futures industry;

e. to reduce systemic risks in the securities and futures industry; and

f. to assist the Financial Secretary in maintaining the financial stability of Hong Kong by taking appropriate steps in relation to the securities and futures industry.

The SFC is divided into four operational divisions:

a. The Corporate Finance Division is responsible for the dual filing functions in relation to listing matters, administering the Takeovers and Mergers Code and Share Repurchases Code, overseeing the Stock Exchange's listing-related functions and responsibilities, and administering securities and company legislation relating to listed and unlisted companies.

b. The Intermediaries and Investment Products Division is responsible for devising and administering licensing requirements for securities and futures, and leveraged foreign exchange trading intermediaries, supervising and monitoring intermediaries’ conduct and financial resources, and regulating the public marketing of investment products.

c. The Enforcement Division is responsible for conducting market surveillance to identify market misconduct for further investigation, undertaking inquiry into alleged breaches of relevant ordinances and codes, including insider dealing and market manipulation, and instituting disciplinary procedures for misconduct by licensed intermediaries.

d. The Supervision of Markets Division is responsible for supervising and monitoring activities of the exchanges and clearing houses, encouraging development of the securities and futures markets, promoting and developing self-regulation by market bodies.

4. HKEx

HKEx is a recognised exchange controller under the SFO. It owns and operates the only stock exchange and futures exchange in Hong Kong and their related clearing houses, namely Hong Kong Securities Clearing Company Limited (HKSCC), HKFE Clearing Corporation Limited (HKCC) and The SEHK Options Clearing House Limited (SEOCH).

Securities Identification:
The National Numbering Agency (NNA) appointed the HKEx to assign and update the ISIN codes for those securities listed on the SEHK and registered in Hong Kong. For other Hong Kong listed securities which are registered outside Hong Kong, the ISIN codes assigned and updated by the National Numbering Agencies or their substitute agencies of the corresponding countries will be used. The ISIN codes are available for ordinary shares, debt securities, warrants and trusts. SEHK also uses local 5 digit codes to identify listed securities.

5. The Stock Exchange of Hong Kong Limited (Stock Exchange)

The Stock Exchange, a wholly-owned subsidiary of HKEx, is a recognised exchange company under the SFO. It operates and maintains a stock market in Hong Kong and is the primary regulator of Stock Exchange Participants with respect to trading matters and of companies listed on the Main Board and Growth Enterprise Market (GEM) of the Stock Exchange.

6. Hong Kong Futures Exchange Limited (Futures Exchange)

The Futures Exchange, a wholly-owned subsidiary of HKEx, is a recognised exchange company under the SFO. It operates and maintains a futures market in Hong Kong and is the primary regulator of Futures Exchange Participants with respect to trading matters.

7. Clearing Houses

HKSCC, SEOCH and HKCC, wholly-owned subsidiaries of HKEx, are recognised clearing houses for the purposes of the SFO. HKSCC and SEOCH provide services for the clearing and settlement of securities and stock option transactions respectively, including trades and transactions effected on, or subject to the rules of, the Stock Exchange. HKCC provides services for the clearing and settlement of transactions on the Futures Exchange.

B. Regulation of the Hong Kong securities markets

1. Rough legislative framework

The key legislation in the Hong Kong capital market is the Securities and Futures Ordinance (SFO).

The securities and futures markets in Hong Kong are currently governed by the SFO. The SFO consolidates and modernises the 10 previous ordinances regulating the securities and futures markets. The primary legislation and the subsidiary legislation commenced operation on 1 April 2003.

The provisions of the SFO provide the Securities Futures Commission to carry out the following activities:

Regulate

a. Licensed corporations and individuals who carry out the following activities in the stock and futures market:
i. dealing in securities and futures contracts
ii. leveraged foreign exchange trading
iii. advising on securities, futures contracts and corporate finance
iv. providing automated trading services, securities margin financing, asset management

b. Hong Kong Exchanges and Clearing Limited
c. All stock exchange listed companies
d. Approved share registrars
e. Investor Compensation Company Ltd
f. All other participants involved trading activities

2. Trading Rights

By law, any person carrying on a business of dealing in securities, or carrying on a business of dealing in futures contracts in Hong Kong, has to be licensed by the SFC or fall within one of the licensing exemptions.

In addition, the rules promulgated by the Stock Exchange and Futures Exchange require any person who wishes to trade on or through their respective facilities to hold a Trading Right.

The Trading Right confers on its holder the eligibility to trade on or through the relevant exchange.

However, the holding of a Trading Right does not, of itself, permit the holder to actually trade on or through the relevant exchange.

In order to do this, it is also necessary for the person to be registered as a participant of the relevant exchange in accordance with its rules, including those requiring compliance with all relevant legal and regulatory requirements.

Stock Exchange Trading Rights and Futures Exchange Trading Rights are issued by the Stock Exchange and Futures Exchange at a fee and in accordance with the procedures set out in their respective rules.

Alternatively, Stock Exchange and Futures Exchange Trading Rights can be acquired from existing Trading Right holders subject to the rules of the respective exchanges.

C. Issuing debt instruments related regulations / rules

1. For bonds to be listed on the Hong Kong Stock Exchange, bond issuers should observe, among others, the Listing Rules which set out the qualifications for listing, application procedures and requirements, listing documents and arrangements etc. For details, refer to Chapters 22-37 of the Listing Rules which can be accessed at http://www.hkex.com.hk/eng/rulesreg/listrules/mbrules/vol1_4.htm.
2. For bonds to be listed on the Hong Kong Stock Exchange, trading Rules (http://www.hkex.com.hk/eng/rulesreg/traderules/tradingrules.htm) promulgated by the Hong Kong Exchange and Clearing Limited should be observed.

3. For unlisted bonds which are regarded as structured investment products and are intended to be sold to the public, bond issuers should observe, among others, the requirements set out in the Code on Unlisted Structured Investment Products published at SFC’s website http://www.sfc.hk/sfc/doc/EN/intermediaries/products/handBooks/Eng_SIP.pdf.

4. Save for the above and the specific laws mentioned above bonds issued by different types of entities, there are in general no other regulations governing the issuance of listed or non-listed bonds in Hong Kong, i.e.

   a. Both domestic and foreign entities are eligible to issue debt instruments in Hong Kong.
   
   b. Foreign entities interested in raising funds in Hong Kong should however ascertain whether it is permitted under the law of their jurisdictions.
   
   c. If the debt instruments are to be listed on the Hong Kong Stock Exchange, issuers have to comply with the requirements for reporting and disclosure of information, etc. as set out in the Listing Rules and other relevant documents of the Hong Kong Stock Exchange.
   
   d. Unlisted Public Offering Bond issuers should obtain SFC’s authorization for issuance of unlisted debt instruments which are regarded as structured investment products and are intended to be sold to the public.

D. Buying debt instruments related regulations / rules (Investment in debt securities)

1. Unless otherwise stated in the prospectus, offer document, term sheet or similar document etc., there is no restriction on the types of investors who are eligible for investing in particular debt instruments.

2. Foreign investors, whether institutional or retail, should however ascertain whether it is permitted under the law of their jurisdictions.

3. From distributors’ and intermediaries’ point of view, they are however required to observe the guidelines issued by the HKMA and the Code on Unlisted Structured Investment Products issued by SFC, where applicable, when selling unlisted securities including debt instruments to retail investors, particularly elderly customers and first-time buyers with high investment concentration.


E. Investor Protection
1. The Investor Compensation Fund (ICF)

The Investor Compensation Fund (ICF) was introduced on April 1, 2003 under the Securities and Futures Ordinance.

The Investor Compensation Company Limited (ICC) was established for administration of claims received under the ICF.

The maximum compensation limit for each claim was pegged at HKD 150,000.

The main aim of the ICF is to pay compensation to those investors (any nationality) who suffer financial losses on account of a default on the part of a licensed intermediary or an authorized financial institution in relation to exchange-traded products in Hong Kong.

Prior to the enactment of the SFC Ordinance there were two separate investor compensation schemes called the Unified Exchange Compensation Fund ("UECF") and the Commodity Exchange Compensation Fund ("CECF") managed respectively by the Stock Exchange of Hong Kong Limited and the Hong Kong Futures Exchange Limited.

The main source of income for the ICF is from the Investor Protection Levy imposed on each exchange-traded product transaction. The current levy is as follows:

<table>
<thead>
<tr>
<th>Nature of Transaction</th>
<th>Amount Payable</th>
</tr>
</thead>
<tbody>
<tr>
<td>Securities transactions</td>
<td>0.002% payable by both buyer and seller</td>
</tr>
<tr>
<td>Futures contract</td>
<td>HKD 0.5 per side of a contract or HKD 0.1 per side of a mini contract or stock futures contract</td>
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</tbody>
</table>

Effective, December 19, 2005, the payment of Investor Compensation Levy has been suspended by the SFC as the net asset value of the compensation fund exceeds HKD1.4 billion.

The other sources of ICF funds are bank interest earned on deposits maintained and transfers made from the UECF and CECF.

F. Taxation Framework and Tax requirements

1. Residents and non-residents investing in the Hong Kong market are charged no withholding tax on dividends and fixed income. Interest income derived from bond holding is not taxable for individuals. For corporations, interest on bonds issued by the government and government related entities are not taxable; other interest is taxable if it has a Hong Kong source. Thus, interest on a corporate bond listed on the Hong Kong Stock Exchange is taxable.

2. Currently, full exemption from profits tax for interest income and trading profits in respect of certain debt instruments is granted under section 26A of the Inland Revenue Ordinance (http://www.hklii.hk/hk/legis/en/ord/112/). These debt instruments include, inter alia, long term debt instruments with an original maturity of not less than 7 years.

3. In addition, pursuant to section 14A of the Inland Revenue Ordinance, a tax concession at 50% of the normal profits tax rate was applied to interest income and trading profits derived from a debt instrument which satisfies the relevant criteria including the following: (see 5 below)

   a. it is lodged with and cleared by the CMU operated by the HKMA;
b. it has an original maturity of not less than 3 years but less than 7 years;
c. it has a minimum denomination of HK$50,000 or its equivalent in a foreign currency;
d. it is issued to the public in Hong Kong; and
e. It is issued by a person and has at all relevant times a credit rating acceptable to the HKMA from a credit rating agency recognized by the HKMA (which is currently set at minimum BBB from Standard and Poor’s).

Residents and non-residents investing in the Hong Kong market are charged no withholding tax on dividends and fixed income.

<table>
<thead>
<tr>
<th>Duties and Tax</th>
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<tbody>
<tr>
<td><strong>Withholding Tax (WHT)</strong></td>
</tr>
<tr>
<td>WHT – Equities</td>
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<tr>
<td>WHT - Fixed Income</td>
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<tr>
<td>Capital Gains</td>
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<tr>
<td>Stamp Duty</td>
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<td></td>
</tr>
<tr>
<td>Other Taxes</td>
</tr>
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<td></td>
</tr>
</tbody>
</table>

Withholding Tax

There is no withholding tax on the dividends and the interests in Hong Kong.

Tax Treaties (Double Taxation Avoidance)

There is no Withholding Tax on Dividend and Interest in Hong Kong. Hence there are no Double Taxation Avoidance (DTA) treaties with respect to dividend and interest received on Hong Kong securities and no tax reclamation procedures are applicable.

Stamp Duty

The following Stamp duty is applicable on securities traded in Hong Kong.

- Stamp Duties and transaction levies are payable on transactions by both buyer and seller. The stamp duty is charged at 0.1% of the consideration by the Inland Revenue Department of Hong Kong, on both the buyer and the seller. Any fraction in ad valorem stamp duty will be rounded up to the nearest HKD1.

- A transfer stamp duty must be paid by the seller on transactions for securities which are physically settled and not cleared by the CCASS. This transfer stamp duty is charged at the rate of HKD5 per Transfer Deed by the Inland Revenue Department.
of Hong Kong.

For trades executed on HKEx the stamp duty is included in the contract note issued by the broker. The broker pays ad valorem stamp duty on behalf of their clients on T+2. It is the responsibility of the investor to ensure that stamp duty is paid at the correct rate; else severe penalties can be imposed for non-payment of stamp duty under the Stamp Duty Ordinance.

As per the Ordinance, on change in the beneficial ownership of shares, ad valorem stamp duty is payable:

- Within 2 days for trades (on exchange or off-market) executed in Hong Kong
- Within 30 days for off-market trades executed outside Hong Kong

Capital Gains Tax

There is no capital gains tax in Hong Kong.

4. The QDI (the qualifying debt instrument) scheme

An active and diverse debt market is important to the further development of Hong Kong as an international financial centre.

The QDI (the qualifying debt instrument) scheme was formulated with the policy intention of developing and enhancing the competitiveness of the local debt market.

For the QDI scheme to achieve its policy intention, enhancements need to be introduced from time to time in response to the changing market landscape and measures adopted by other financial centres in the region for developing their respective debt markets.

Interest income and trading profits of debt instruments issued and traded in Hong Kong are chargeable to profits tax under the Inland Revenue Ordinance (“IRO”) as stated above.

Currently, a 100% exemption from profits tax for interest income and trading profits arising from certain categories of debt instruments is granted pursuant to section 26A of IRO as stated above.

These debt instruments include government bonds, Exchange Fund debt instruments, Hong Kong dollar denominated multilateral agency debt instruments, and long-term debt instruments with an original maturity of seven years or longer.

In addition, under section 14A of IRO, a tax concession at 50% of the normal profits tax rate is applied to interest income and trading profits derived from a debt instrument that satisfies the relevant criteria stated above (3.a-e).

Notwithstanding the refinements introduced to the QDI scheme in 1999 and 2003 respectively, the percentage of QDI issuance in Hong Kong’s total debt issuance remained small. Only 4% of Hong Kong’s total debt issuance have been QDI issuance since the last
refinement in 2003.

There was still room for improving the scheme to enable it to better serve its policy objectives.

The government have conducted a review of the QDI scheme and identified several areas for improvement.

First, the structure of the tax incentives offered under the scheme does not match the landscape of Hong Kong's corporate bond market. While Hong Kong's corporate bond market is dominated by privately-placed short-term debt instruments with an original maturity of less than three years (46% of total issuance), the scheme only offered tax incentives to debt instruments with an original maturity of three years or more and which are “issued to the public”.

Second, since the “issued to the public” criterion is not clearly defined in IRO, there were some uncertainties in the market about how such criterion should be interpreted in practice.

In addition, the eligibility criteria of the scheme appeared to be more stringent than those of similar schemes in other financial centres in the region.

To address the issues mentioned above, the government proposed to make some enhancements to the QDI scheme.

These enhancement measures, which aim to strike a balance between meeting the market development needs and minimising the risk of tax avoidance, are expected to help further develop the local debt market and put Hong Kong on a more equal footing with other financial centres in the region in attracting debt market activities.

5. Extending Tax Concession to Short-term Debt Instruments

First, government proposed that the 50% tax concession previously granted under section 14A of IRO be extended to interest income and trading profits derived from debt instruments with an original maturity of less than three years.

This proposed amendment aims to place short-term debt instruments on a level-playing field with longer-term debt instruments in respect of profits tax treatment.

As an international financial centre, Hong Kong should aim at developing a debt market that is deep, active and diverse, and with a wide spectrum of participants (including issuers, investors and services providers) as well as issues.

This proposed amendment is expected to help stimulate new demand for bond issues in Hong Kong.

G. Offers of bonds to professionals

1 Generally,

a. An offer to sell bonds to professional investors (as defined below) is not required to comply with the prospectus requirements in the Companies Ordinance (Paragraph 1 of Schedule 17 to the CO).
This is contrasted with a general offer of bonds to retail investors of the general public, which would have to comply with a host of prospectus requirements in the CO.

b. “Professional investor” includes any authorised financial institution, any recognised exchange company, recognised clearing house, any authorised insurer, any investment services intermediary, collective investment scheme, any government, institution that performs the functions of a central bank and any high net worth individuals (section 1 of Part 1 of Schedule 1 to the SFO).

c. “Prospectus” means any prospectus, notice, circular, brochure, advertisement or other document offering any shares in or debentures in a company to the public for subscription or purchase for cash or other consideration; or calculated to invite such offers, with certain exceptions, for example, prospectus that relates to an offer to sell bonds to professional investors (as discussed above).

2 Offers of bonds listed on Exchange markets

a. There are a set of modified rules for listing application for issues of selectively marketed securities on the HKSE (chapter 37 of the Listing Rules). The requirements are relaxed compared to the rules for listing of debt securities in general in chapters 24-26 (e.g. shorter period of audited accounts and longer period between listing document and latest financial period in the latest audited accounts).

b. In order to qualify as “selectively marketed securities”, the offer and sale of the bonds is restricted so that they are marketed to or placed with any number of registered dealers or financial institutions either with a view to their reselling such securities as principals off-market, and the bonds are of such a nature that nearly all of them will normally be purchased and traded by a limited number of investors who are particularly knowledgeable in investment matters or placing such bonds with a limited number of such investors.

H. Definition of “professional investors” in the HKSAR (Special Administrative Region)

The definition of “professional investor” may be found in the following parts: Professional investor definition can be found mainly in SFO; but after Lehman collapse, more clarifications needed to be made.

1. Paragraph (j) of Part 1 of Schedule 1 to the Securities and Futures Ordinance (Cap.571) (“SFO”) (which provides a list of persons or entities recognised as “professional investors”); and

2. Section 3 of the Securities and Futures (Professional Investor) Rules (Cap.571D) (which extends the definition of “professional investor” to specified high net worth individuals and entities).

3. SELECTIVELY MARKETED SECURITIES status in listing rule (Chapter 37) on the STOCK EXCHANGE is related to the concept of professional investors to some extent.

1. Paragraph (j) of Part 1 of Schedule 1 to the SFO

"Professional investor“ means-

a. any recognized exchange company, recognized clearing house, recognized
exchange controller or recognized investor compensation company, or any person authorized to provide automated trading services under section 95(2) of this Ordinance;

b. any intermediary, or any other person carrying on the business of the provision of investment services and regulated under the law of any place outside Hong Kong;

c. any authorized financial institution, or any bank which is not an authorized financial institution but is regulated under the law of any place outside Hong Kong;

d. any insurer authorized under the Insurance Companies Ordinance (Cap 41), or any other person carrying on insurance business and regulated under the law of any place outside Hong Kong;

e. any scheme which-

i. is a collective investment scheme authorized under section 104 of this Ordinance; or

ii. is similarly constituted under the law of any place outside Hong Kong and, if it is regulated under the law of such place, is permitted to be operated under the law of such place,

iii. or any person by whom any such scheme is operated;

f. any registered scheme as defined in section 2(1) of the Mandatory Provident Fund Schemes Ordinance (Cap 485), or its constituent fund as defined in section 2 of the Mandatory Provident Fund Schemes (General) Regulation (Cap 485 sub. leg. A), or any person who, in relation to any such registered scheme, is an approved trustee or service provider as defined in section 2(1) of that Ordinance or who is an investment manager of any such registered scheme or constituent fund;

g. any scheme which-

i. is a registered scheme as defined in section 2(1) of the Occupational Retirement Schemes Ordinance (Cap 426); or

ii. is an offshore scheme as defined in section 2(1) of that Ordinance and, if it is regulated under the law of the place in which it is domiciled, is permitted to be operated under the law of such place,

iii. or any person who, in relation to any such scheme, is an administrator as defined in section 2(1) of that Ordinance;

h. any government (other than a municipal government authority), any institution which performs the functions of a central bank, or any multilateral agency;

i. except for the purposes of Schedule 5 to this Ordinance, any corporation which is-
i. a wholly owned subsidiary of-

   (a) an intermediary, or any other person carrying on the business of the provision of investment services and regulated under the law of any place outside Hong Kong; or

   (b) an authorized financial institution, or any bank which is not an authorized financial institution but is regulated under the law of any place outside Hong Kong;

ii. a holding company which holds all the issued share capital of-

   (a) an intermediary, or any other person carrying on the business of the provision of investment services and regulated under the law of any place outside Hong Kong; or

   (b) an authorized financial institution, or any bank which is not an authorized financial institution but is regulated under the law of any place outside Hong Kong; or

iii. any other wholly owned subsidiary of a holding company referred to in subparagraph (ii); or

j. any person of a class which is prescribed by rules made under section 397 of this Ordinance for the purposes of this paragraph as within the meaning of this definition for the purposes of any provision of this Ordinance;

2. The definition of “professional investor” includes the following individuals and entities under section 3 of the Securities and Futures (Professional Investor) Rules.

For the purposes of paragraph (j) of the definition of "professional investor" in section 1 of Part 1 of Schedule 1 to the Ordinance above, the following persons are prescribed as within the meaning of that definition for the purposes of any provision of the Ordinance other than Schedule 5-

a. any trust corporation having been entrusted under the trust or trusts of which it acts as a trustee with total assets of not less than $40 million or its equivalent in any foreign currency-

   i. as stated in the most recent audited financial statement prepared-

      (a) in respect of the trust corporation; and

      (b) within 16 months before the relevant date;

   ii. as ascertained by referring to one or more audited financial statements, each being the most recent audited financial statement, prepared-

      (a) in respect of the trust or any of the trusts; and

      (b) within 16 months before the relevant date; or
iii. as ascertained by referring to one or more custodian statements issued to the trust corporation-
   (a) in respect of the trust or any of the trusts; and
   (b) within 12 months before the relevant date;

b. any individual, either alone or with any of his associates on a joint account, having a portfolio of not less than $8 million or its equivalent in any foreign currency-
   i. as stated in a certificate issued by an auditor or a certified public accountant of the individual within 12 months before the relevant date; or (23 of 2004 s. 56)
   ii. as ascertained by referring to one or more custodian statements issued to the individual (either alone or with the associate) within 12 months before the relevant date;

c. any corporation or partnership having-
   i. a portfolio of not less than $8 million or its equivalent in any foreign currency; or
   ii. total assets of not less than $40 million or its equivalent in any foreign currency, as ascertained by referring to-
   iii. the most recent audited financial statement prepared-
      (a) in respect of the corporation or partnership (as the case may be); and
      (b) within 16 months before the relevant date; or
   iv. one or more custodian statements issued to the corporation or partnership (as the case may be) within 12 months before the relevant date; and

d. Any corporation the sole business of which is to hold investments and which is wholly owned by an individual who, either alone or with any of his associates on a joint account, falls within the description in paragraph (b).

I. Challenges / Expected changes

1. Consultation for the Professional investors only market

   The Hong Kong Exchanges and Clearing Limited are undergoing market consultation on some proposed changes to the requirements for the listing of debt issues to professional investors only.

   The proposed changes include, but not limited to the following:

   a. to unify the definition of professional investors in the Listing Rules with the definition in the Securities and Futures Ordinance stated above;
   
   b. to replace the current detailed disclosure requirements with an obligation to include information that is customary for offers of debt securities to
professionals, as there is perception that listing in Hong Kong is more document intensive than other jurisdictions such as Singapore; and

c. To streamline the application procedures.


2. Enhancement measures to the qualifying debt instrument scheme

Regarding the taxation regime, as announced in the Financial Secretary’s Budget for 2010-11, the Government will introduce enhancement measures to the qualifying debt instrument scheme mentioned in E.3 above.

Specifically, the Government will extend the 50% tax concession to interest income and trading profits derived from debt instruments with an original maturity of less than 3 years with a view to encouraging a wider spectrum of participants and stimulating new demand for debt instrument issuance activity.

3. Clarification of the “issued to the public” criterion

Also, the Government clarified the “issued to the public” criterion in the Inland Revenue Ordinance so as to better meet the market requirement.


Replacing the “Issued to the Public” Criterion by a New Requirement

To remove the uncertainties concerning what constitutes “issued to the public” as stipulated in paragraph (e) of the definition of “debt instrument” in section 14A(4) of IRO, the government proposed to replace the “issued to the public” Criterion by a new requirement that, at issuance, the instrument is issued in Hong Kong to –

a. ten or more persons; or

b. If less than ten persons, none of whom is an associate of the issuer of the instrument.

The “issued to the public” criterion has been introduced to address potential tax avoidance through arranging as QDIs intra-group or inter-group debt issues that are otherwise not necessary so as to enjoy tax benefits.

However, since IRO does not specify what constitutes “issued to the public”, the legal uncertainties involved have put many debt market participants off using the QDI scheme.

The proposed amendment has been formulated taking into account the landscape of
Hong Kong’s debt market and the criterion’s original intent of preventing tax avoidance.

In drawing up the proposal, the government have made reference to similar schemes overseas which are considered successful in facilitating the development of the relevant local debt market.

For instance, under Singapore’s scheme, debt securities would be deemed “issued to the public” if they are issued to four persons or more; or have less than 50% of the issue of debt securities being beneficially held or funded by related parties of the issuer of those debt securities at the time of primary launch. If, at any time during the life of an eligible debt issue, 50% or more of the issue is beneficially held or funded, directly or indirectly, by a related party of the issuer, the portion of the issue held by related parties will not be eligible for tax concessions under the scheme. On the other hand, under Australia’s scheme, issuers are only required to offer the issue to a specified minimum number of potential investors. No requirement is set on the number of investors to whom the debt securities are ultimately issued.
III. Trading of Bonds and Trading Market Infrastructure

There are various types of debt securities listed on the SEHK. These include corporate bonds, convertible bonds, exchange fund notes.

The securities (mainly shares) listed and traded on the SEHK are also in scripless form and holders CCASS accounts are credited or debited for securities purchased and sold respectively.

Besides the above standard securities the following instruments are also available for trading on the HKEx namely, Equity Linked Instruments, Exchange Traded Funds.

In December 1993, the HKMA extended their settlement and clearing facilities to debt securities traded on the SEHK.

But, as far as the debt securities concerned, many listed bonds are not traded on the SEHK.

A. Exchange trading

Listed bonds are mainly traded in the OTC market and in some cases traded on the Hong Kong Stock Exchange whereas unlisted bonds are traded in the OTC market.

If bonds are listed and traded on the Hong Kong Stock Exchange, the prevailing bid and ask prices, yield to maturity and certain static information such as the bond's coupon rate and maturity date, are usually disseminated by the Hong Kong Stock Exchange through information vendors to the market.


B. OTC market trading

If bonds are traded in the OTC market, any interested investors can obtain direct access to relevant information supplied by various financial information providers (e.g. Bloomberg and Reuters), or rely on the intermediaries such as distributing banks to get such information.

In Hong Kong, bonds may be held within the CMU Service operated by the Hong Kong Monetary Authority ("HKMA") in either definitive or global instrument form.

The CMU Service provides a central depositary service for CMU Instruments held within the CMU Service and an electronic book-entry system for electronic trading between CMU Members of CMU Instruments without physical delivery of CMU Instruments.

The bond instruments must be lodged with a sub-custodian appointed by the HKMA.

The bond issuer must either be a CMU Member or authorise a CMU Member as a Lodging Agent in order to use the depositary services of the CMU Service.

While the bonds are represented by global notes, the CMU Lodging Agent holds the
legal title of these bonds, which are then “immobilised” via the CMU accounts.

The holders of the CMU accounts hold the bonds in the “Main Account” for the benefit of themselves, and the bonds in the General/Specific Custody Accounts for and on behalf of their own customers.

For the bonds held in the General/Specific Custody Accounts, the CMU Members would have to refer to their own internal records to ascertain the beneficial ownership of the bonds held in such accounts.

The Issuer and the Paying Agent directly make payments of principal, interest or any amounts to the persons for whose accounts interests in the global bond are credited (as set out in a CMU Instrument Position Report, or as notified to the CMU Lodging Agent by the CMU Service).

The individual beneficial holders will have to rely on the CMU Member or the CMU Lodging Agent for the delivery of payments and notices to them.

Trading of debt securities lodged with the CMU is subject to the EFBN and CMU Service Reference Manuals (which are accessible by CMU members only) and other relevant documents.

Furthermore, for the trading activities of bonds lodged with the CMU, refer to the CMU Bond Price Bulletin website (http://www.info.gov.hk/hkma/eng/infra/index.htm, scroll down to “CMU Bond Price Bulletin” section and click the hyperlink) provides investors with convenient online access to indicative bond prices quoted by the major banks and securities firms in Hong Kong.

Some intermediaries with bond trading services will also post bond price information on their websites.

C. OTC market business process

1. The seller and the buyer trade over the counter.
2. The seller and the buyer send instructions to Central Money-markets Unit (CMU) via CMT, SWIFT, Fax, AFT or by hand.
3. CMU performs validation and matching.
4. (CMU sends matching result to the seller and the buyer.)
5. CMU holds securities.
6. CMU sends settlement data to HKMA.
7. HKMA executes cash settlement.
8. HKMA sends settlement report to CMU. (HKMA sends settlement report to the buyer and CMU.)
9. CMU executes bond settlement.
10. CMU sends settlement confirmation to the seller and the buyer.
Matching is limited to settlement matching (since trading not in CMU itself).

Central matching: two-sided input or input and affirmation (alleged trade) supported; e.g. Bloomberg can send trade details directly into CMU.

Blocking of securities positions only on Settlement Date.

Settlement upto 4pm.

T+0 for Exchange Fund papers.

eCMT = CMU front-end system, allows enquiry for participants for trade/detail capture.

Terminology: CHATS equals RTGS.

CMU supports multiple securities identifiers.

Account structure: 1 account per firm for RTGS, multiple or sub-accounts in CMU.

One rule: participants must segregate proprietary and client holdings.

CCASS is a participant at CMU.

Foreign entities can open accounts directly with CMU.

Auto-repo is possible.
Terminology: clearing = netting service for participants, i.e. for EOD settlement.

No CCP at present.

Settlement cycle = T+1 for government paper, T+2 for other bonds.

CMU allows capture, and matching, of trades with SD upto 30 days in the future.

CMU uses MT54x messaging.

Matching results can be undone between counterparties.

99% of trades settle in EOD settlement segment; settlement is EOD but securities are still settled gross.

Linkages: no commercial arguments easily forthcoming, but potentially significant for movement of collateral; target group is corporate customers.

D. HONG KONG Bond Transaction Flow (For Foreign Investors)

Trade Date: T
Settlement Date: T+2

OTC Bond Transaction Flow for Foreign Investors Description of Steps

1. Foreign Institutional Investor places order with International Broker
2. International Broker places order with Domestic Broker/Bank
3. Domestic Broker/Bank trades OTC with Counterparty (via phone or, e.g., Bloomberg)
4. Domestic Broker/Bank sends trade confirmation to International Broker
5. Foreign Institutional Investor receives trade confirmation
6. Foreign Institutional Investor instructs Global Custodian, on securities settlement and cash funding details
7. Global Custodian instructs Domestic Custodian on securities settlement
8. Domestic Custodian captures (eCMT or upload) settlement instructions into CMU
9. Domestic Custodian receives transaction matching confirmation from CMU, or status updates
10. Domestic Custodian sends matching status update to Global Custodian, either as report or, typically, per individual transaction
11. Global Custodian advises funding details to Domestic Custodian
12. Domestic Custodian effects funding of HKMA account via CHATS
13. Upon transfer of cash, HKMA sends cash settlement confirmation to Domestic Custodian
14. Upon transfer of bonds, CMU sends bond settlement confirmation to Domestic Custodian
15. Domestic Custodian sends settlement confirmation to Global Custodian
16. Foreign Institutional Investor receives settlement confirmation from Global Custodian
17. Global Custodian funds trades into Domestic Custodian HKD account, or into FCY nostro
18. Domestic Custodian sends securities statement to Global Custodian
19. Domestic Custodian sends debit/credit confirmation as cash statement to Global Custodian
20. Global Custodian sends debit/credit confirmation in cash statement to Foreign Institutional Investor

OTC Bond Transaction Flow for Foreign Investors Additional Comments

- HK bond market is OTC in nature; bond listings on HKEx are for profiling, CCASS is a participant in CMU
- T+2 seen as representative settlement cycle, in particular when involving FII; government bonds may otherwise typically settle T+1, and Exchange Fund papers are on T+0 settlement cycle
- eCMT is CMU front-end tool, for viewing and data capture
- CHATS = HKMA RTGS
- Due to the matching feature in CMU, there is no specific need for pre-matching between counterparties and/or custodians
- HK is a very open market, 3rd Party FX is entirely possible and well utilised, and HKD liquidity is available in most financial markets; also, Global Custodian may have own treasury function based in HK; hence, assumption that trades are funded on SD
- 15,16 – assumed to happen in quick succession, since HKD can be funded same day, even by FII or FM directly on same day, hence sequence shown

[ADB Consultant: MS]
Ⅳ. Possible item of Impediments / Restrictions

A. Repo market

Banks holding exchange fund bills / notes can obtain financing from the HKMA through intraday repo or discount window.

Bank repo with the types of eligible debt securities bilaterally agreed by both parties is also supported though the market remains insignificant for the time being.

B. Liquidity in the secondary market

In 2009, the CMU processed a daily average value of HK$172 billion (242 transactions) in secondary market transactions.

The debt securities traded in the secondary market were dominated by exchange fund bills / notes, with only a tiny portion trading private debt issues.

On the other hand, the secondary market of the bonds listed on the Hong Kong Stock Exchange was comparatively inactive.

In 2009, the aggregate turnover of debt securities traded on the Hong Kong Stock Exchange amounted to HK$3.97 million only.

C. RMB denominated bond market

Bonds issued in Hong Kong were mainly denominated in Hong Kong dollars or US dollars before 2007.

Since the first RMB denominated bonds issued by China Development Bank in July 2007, the market has seen an increasing number and value of bonds issued in RMB.

As of end-January 2011, the outstanding balance of RMB bonds lodged with the CMU amounted to RMB67 billion.

In 2011, RMB bonds have reached 100bn RMB outstanding.

In addition to financial institutions and the Mainland Government, some multinational corporations such as McDonald’s and Caterpillar have also tapped the RMB bond market in Hong Kong.

Funds raised by bond issuers can be remitted back to the Mainland in form of shareholders’ loan or equity capital injection subject to approval of the relevant Mainland authorities.

They can also be used for any other purposes outside the Mainland as there is no restriction on the usage of RMB in the offshore market.

D. Conclusion

Overall speaking, we do not see any impediments that hinder the development and growth of bond market in Hong Kong. Nonetheless, the Government and Hong Kong Exchanges and Clearing Limited have identified some areas for improvement and are undergoing various procedures to put the enhancements in place as soon as practicable.
### A. Securities settlement infrastructure

1. **CMU**

   The CMU is the debt securities clearing and settlement system in Hong Kong operated by the HKMA.

   Established in 1990, the CMU provides an efficient clearing, settlement and custodian service for debt securities denominated in Hong Kong dollars and other major currencies.

   It also provides an electronic book-entry system which eliminates the physical delivery of debt securities between CMU members.

   These debt securities include exchange fund bills / notes, Government bonds, and debt securities issued by both public and private sector entities.

   In December 1996, a seamless interface between the CMU and HKDollar RTGS system was established. Such linkage provides real-time and end-of-day delivery versus payment (DvP) services to CMU members.

   The CMU was further linked to the USD, euro and RMB RTGS systems in December 2000, April 2003 and March 2006 respectively to provide real-time DvP capability for debt securities denominated in these currencies, and also intraday and overnight repo facilities for the respective payment systems in Hong Kong.
The CMU has also developed external links with regional central securities depositories and international central securities depositories such as Euroclear and Clearstream.

The linkages enable international investors to hold and settle CMU securities through these international networks, and enable investors in Hong Kong and other parts of Asia to hold and settle Euroclear and Clearstream debt securities directly in a secure DvP environment via their CMU members.

In terms of settlement arrangements, if the debt securities are settled using real-time DvP mode, both cash and securities legs are settled on a gross basis. If the debt securities are settled using end-of-day DvP mode, both cash and securities are settled on a net basis.

If the securities are settled using free of payment (FOP) mode, settlement will be done in gross basis for real-time FOP or net basis for end-of-day FOP.

Besides provision of clearing, settlement and custody services, the CMU also provides a tendering platform to facilitate price discovery and enhance price transparency.

In November 2010, the Mainland’s Ministry of Finance used the CMU Bid service for the first time for tendering of RMB sovereign bonds among institutional investors. The tendering attracted a huge number of applications with highly competitive pricing, with the coupon rate of the 3-year, 5-year and 10-year issues fixing at 1%, 1.8% and 2.48% respectively.

HKMA/CMU encourages use of RTGS but can also settle net at EOD; this available for trades that have passed cut-off time(s); presently 90% of trades settle in EOD mode (because counterparties are covering short positions).

2. Central Clearing and Settlement System (CCASS)

Linkages have also been established between the CCASS operated by the Hong Kong Stock Exchange and HKD, USD and RMB RTGS systems. Similar to the settlement arrangements for debt securities lodged with the CMU, settlement of listed debt securities can be done in real-time or end-of-day, DvP or FOP.

It should however be noted that not all bonds traded on the Hong Kong Stock Exchange are cleared and settled through the CCASS. Some of the listed debt securities are cleared and settled through the CMU.

Examples of which include exchange fund bills / notes issued by the HKMA.

B. Definition of Clearing and settlement

1. Clearing

   a. Clearing operates after trading and before delivery (or settlement). It involves techniques designed to address the risk of counterparty default after trading and before settlement, primarily through the netting of mutual post-trade obligations of market participants and the use of a well-capitalised intermediary (known as the clearing house). The clearing house assumes the contractual obligations of each party to settle
the trade.
Even if one party defaults post-trade and pre-settlement, settlement will still go ahead.

b. Whilst instructions to transfer bonds must be sent to the CMU Service (by CMU Member Terminals, SWIFT, by hand or by post, by fax or by telex), the CMU Service provides limited clearing services. For example, it does not perform the standard clearing services in the capacity of a central counterparty; the transfers are directly made between the CMU Members themselves. For that reason, all DvP transactions under the CMU are subject to the credit risk of the settlement banks.

c. Also, the CMU Service does not provide any facilities for the dissemination to the relevant CMU Members of any payments of interest or principal under, or notices pursuant to the notice provisions of, CMU Instruments. Instead the HKMA (as operator of the CMU Service) advises the lodging CMU Member (or the designated paying agent) of the identities of the CMU Members to whose accounts payments in respect of the relevant CMU Instruments are credited, whereupon the lodging CMU Member (or the designated paying agent) will make the necessary payments of interest or principal or send notices directly to the relevant CMU Members.

d. The CMU Service has linkages with Euroclear and Clearstream to facilitate clearing and settlement of cross-border securities transactions on a DvP basis via the CMU Members.

e. For listed bonds, the Hong Kong Securities Clearing Company Limited (HKSCC) does not provide any physical depositary services in respect of CMU Instruments. However, as a result of clearing and settlement of transactions in CMU Instruments effected on the HKSE, allocation following an application for CMU Instruments made through the Central Clearing and Settlement System (CCASS), or the provision of other CCASS services to the CCASS Participants, CMU Instruments may be credited to and debited from CCASS Participants’ stock accounts.

i. CCASS is a clearing system for the HKSE. CCASS operates a continuous netting system for netting of the holdings of interests in the CCASS securities accounts. As the HKSCC (the operator of CCASS) is the central counterparty with which the market participants deal directly, they only bear the credit risk of HKSCC, not of the other market participant.

ii. Settlement happens two trading days after the date of the transaction on the HKSE.

2. Settlement

a. Settlement means delivery (usually against payment). Once a trade has taken place, the buyer is contractually bound to deliver the securities to the seller, and the seller is contractually bound to pay the purchase price to the seller. Settlement of securities through electronic systems usually takes the form of synchronised payment and delivery sides of each transaction.
f. The CMU Service provides the following settlement facilities:

i. The CMU Service provides a real time and end-of-day Delivery versus Payment (DvP) facility for transactions denominated in HKD, RMB, EUR and USD through the RTGS systems.
The HKMA as operator of the CMU Service will match the debit instruction with the corresponding credit instruction, including information on the settlement date, buyer and seller accounts, issue number, nominal currency and amount, settlement mode, currency and amount.
The real-time settlement of the transaction will happen immediately once both the payment funds are available from the settlement bank and the seller’s securities account holds sufficient securities.
(It also offers Free of Payment (FoP) facility as an alternative.)
DvP means delivery of securities simultaneously upon transfer of the funds for payment on a trade by trade basis, whereas FoP means delivery of securities with no corresponding payment of funds.

ii. Cross-border DvP Settlement is effected via regional central securities depositories (CSDs) and international central securities depositories (ICSDs).

iii. The CMU Service relies on the interbank settlement system for settlement of transfers of holdings of CMU Members within the CMU Service.

C. Challenges/ Expected changes

The CMU has been functioning smoothly and efficiently and there are no planned material changes to be applied to the CMU as far as settlement arrangement is concerned.
**VI. Cost and charging methods**

A. **Initial Fees**

Refer to attachment 1 for CMU tariff, and attachment 2 for the fee schedule for debt securities listed on the Hong Kong Stock Exchange.

B. **Maintenance (on-going) Costs**

Refer to attachment 1 for CMU tariff, and attachment 2 for the fee schedule for debt securities listed on the Hong Kong Stock Exchange.

The following market charges exist in the Hong Kong Market

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<th>Market Charge</th>
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<tr>
<td>Trading Fees</td>
<td>0.005% per side payable by both Buyer and Seller</td>
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<td>Brokerage Fees</td>
<td>Brokerage Commission on SEHK trades is freely negotiable.</td>
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<td>Registration Fees</td>
<td>Registration fees of HKD2.50 per board lot is charged by the registrar</td>
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<tr>
<td>Stock Exchange Fees</td>
<td>Stock settlement fee of 0.002% will be charged on gross settlement amount.</td>
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VI. Market size / statistics

A. Market size

While the issuance of Hong Kong-dollar debt instruments remained relatively stable at around HK$400 billion annually between 1998 and 2008, the outstanding amount steadily increased from HK$393 billion to HK$717 billion over the same period. In 2009, due to the massive capital inflows and an increasing market demand for exchange fund bills issued by the HKMA, HK$1,048 billion worth exchange fund bills were issued, resulting in a substantial increase in the issuance of Hong Kong-dollar debt instruments from HK$424 billion in 2008 to HK$1,242 billion in 2009.

B. RMB bond market

On the other hand, the RMB bond market has recorded a rapid growth since the issuance of the first RMB denominated bonds in Hong Kong in July 2007. As of end-January 2011, the aggregate value of RMB denominated bonds lodged with the CMU amounted to RMB67 billion. Bond issuers comprised Mainland Government, financial institutions and multinational corporations.

C. Equity market

Among the different means of fund raising activities in Hong Kong (excluding the issuance of exchange fund bills), equity market was the most favourite for fund raisers and amounted to HK$427 billion in 2008, accounting for 59% of the aggregate amount of funds raised. On the other hand, the size of Hong Kong-dollar debt issuance was comparable with that of the syndicated loan, with the former raising HK$138 billion and the latter raising HK$154 billion in 2008.


D. Market data from AsianBondMarketOnline.com

http://asianbondsonline.adb.org/hongkong/data/bondmarket.php?code=LCY_in_USD_Local

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Ⅷ. Presence of an Islamic Finance (Islamic bond (Sukuk)) market

A. Regulatory framework for Islamic Finance in general

Save for the relevant laws relating to tax issues as stated in Ⅷ.D, the regulatory and legal framework for Islamic finance largely follows those applicable to conventional debt instruments.

B. Type of instruments available, segments, tenure, e.g.

Though the market infrastructure, regulatory and legal framework are in place, the market remains inactive for the time being probably due to the tax issues stated in Ⅷ.D.

C. Basic Market infrastructure required to facilitate Islamic Finance (Islamic bonds: Sukuk)

Enhancements have been made to USD and Euro RTGS systems as well as CMU in Hong Kong to facilitate participating members to identify transactions related to Islamic finance and to segregate Islamic-related funds from others.

D. Tax related issues

The key tax issue relating to Islamic bond is that the arrangement operates in the form of equity finance but is in substance similar to debt finance.

In Hong Kong, tax law treats debt and equity differently.

For instance, interest income and interest expenses arising from a debt finance arrangement may be taxable and deductible subject to certain conditions.

In contrast, dividend income and distributions arising from an equity finance arrangement are generally not taxable or deductible.

As a result of heavier tax burden, issuing and/or investing in Islamic bond may be less favourable than issuing and/or investing in conventional debt instruments.

The Government is studying how to take forward amendments to the relevant laws to facilitate development of a local Islamic bond market by levelling the playing field for Islamic bonds vis-à-vis their conventional counterparts as far as tax arrangements are concerned.
**IX. History of Debt Market development**

**A. Overview**

The debt market in Hong Kong began in late 1970s with the first debt instrument issued by a private entity.

There was virtually no debt issued by the Government or related bodies during this period due to cumulative fiscal surplus.

The activities of the debt market thus remained little.

With a view to facilitate the development of local debt market, the HKMA rolled out the Exchange Fund Bills and Notes Programme in 1990.

The amounts of issuance and outstanding debt instruments have shown rapid growth since then.

**B. The Development of Hong Kong Debt Markets**

– Market Overview - Hong Kong Capital Markets Association

http://www.hkcma.org/about_us/market_overview.html

Over the past 10 years, the Hong Kong government has contributed significantly to the growth of capital markets by introducing a number of measures designed to further develop an efficient infrastructure for the Hong Kong dollar bond market. These measures include the establishment in 1990 of the Central Moneymarkets Unit, which provides an efficient settlement, central clearing and custodian system for Hong Kong dollar debt securities, and the introduction of the Exchange Fund Bills and Notes Programme to create a benchmark yield curve extending to 10 years.

1. Central Moneymarkets Unit (CMU)

The Central Moneymarkets Unit (CMU) was set up primarily to provide computerized clearing and settlement facilities for Exchange Fund Bills and Notes. In December 1993, the Hong Kong Monetary Authority (HKMA) extended the service to other Hong Kong dollar debt securities. Since December 1994, the CMU has been linked to international clearing systems such as Euroclear and Cedel. This has helped to promote Hong Kong dollar debt securities to overseas issuers and investors who can make use of these links to participate in the Hong Kong dollar debt market. In December 1996, an interface between the CMU and the Real-Time Gross Settlement (RTGS) interbank payment system was established. This enables the CMU system to provide its members with real-time and end-of-day delivery versus payment (DvP) services. Other market infrastructure enhancements by the CMU include the launching of a Securities Lending Programme for private sector securities in December 1997. The aim of this programme was to enhance the liquidity of private sector debt securities by providing a mechanism to make securities held by long-term investors available for short-term use by more active market participants.

The Hong Kong Monetary Authority launched the Exchange Fund Bills Programme in March 1990. Exchange Fund Bills and Notes are Hong Kong dollar debt securities issued by the HKMA. The Exchange Fund Bills and Notes constitute direct, unsecured, unconditional and general obligations of the Government of the Hong Kong SAR for the account of the Exchange Fund.
The Exchange Fund Bills and Notes Programme ensures the supply of high quality Hong Kong dollar debt paper that can be employed as trading, investment and hedging instruments. Banks that maintain Hong Kong dollar clearing accounts with the HKMA can use their holdings of Exchange Fund paper to borrow Hong Kong dollars overnight from the discount window. Under the programme, bills that have tenors of less than one year are regularly auctioned by way of public tender. To facilitate the management of liquidity by banks participating in the RTGS, three tap issues of 28-day Exchange Fund Bills have been issued since November 1996. As banks in Hong Kong have become more proficient in managing their intraday liquidity, demand for tap issues has fallen. Consequently, the HKMA has gradually reduced the size of each of the tap issues of 28-day Exchange Fund Bills and replaced them with a range of longer term Exchange Fund Notes.

Two-year and three-year Exchange Fund Notes were introduced in May 1993 and October 1993 respectively. This was followed by the inaugural issue of five-year Exchange Fund Notes in September 1994, seven-year Exchange Fund Notes in November 1995 and 10-year Exchange Fund Notes in October 1996.

As at September 30 2002, the value of outstanding Exchange Fund Bills and Notes totalled HK$116 billion.

2. Corporate Bond Market

The private sector bond market is currently just over twice the size of the Exchange Fund Bills and Notes market. As at September 30 2002, the total value of outstanding private sector bonds was HK$408 billion. The largest issuer category was local banks and corporations, followed by international banks and then supranational bodies.

3. Market History

According to available records, the first debt market issue in Hong Kong was a certificate of deposit issue launched in September 1977 by Chase Manhattan Bank. The issue size was HK$100 million – a large issue at the time. It was a five-year issue with a coupon rate of prime but subject to an interest rate floor of 5.25%.

The first fixed rate issue was launched in July 1980. It was an 18-month issue and carried a coupon of 10%. The issuer was Banque Paribas and issue size was HK$70 million. The interbank money market was still rather undeveloped at that time and certificate of deposit issuance was the only way for international banks to raise Hong Kong dollar funds.

The first swap driven issue occurred in 1984 when interest rate swaps were introduced into the Hong Kong dollar market. The coupon of the issue was 11.625% and the swap counterparty was a major property company in Hong Kong.

Supranational issuers have also played an important role in the development of the Hong Kong dollar bond market. The first supranational issue was launched in 1989 by the World Bank which was the first supranational issuer to tap the Hong Kong dollar market after the Hong Kong government granted tax exemption on interest and capital gains on holding supranational paper. The availability of this type of high quality paper helped to attract investor attention and to enlarge the investor base for Hong Kong dollar bonds.
Current Market Conditions
The Hong Kong dollar bond market has developed rapidly in the last several years. New issue volume was below HK$100 billion in 1997 but has grown to a level of between HK$150 billion and HK$180 billion per year in the last two years. While the floating rate market has remained fairly stable, there has been substantial growth in the fixed rate market. This is a result of more conservative investment attitude after the Asian financial crisis and a deflationary environment that gives Hong Kong dollar bond investors an attractive real rate of return.

Excluding the Yen bond market, the Hong Kong dollar market is the second largest Asian currency bond market, ranking just after the Korean won market. It is the most open market among the Asian currency bond markets although in terms of diversity of issuers, the Korean won and the Singapore dollar markets seem to show a greater range.

At a global level, the Hong Kong dollar is an important medium-term note (MTN) issuance currency. In 2001, the volume of MTNs denominated in Hong Kong dollars ranked just after the US dollar, euro, yen and British pound as the fifth most popular issuance currency. However, the average size of Hong Kong dollar issues is small relative to these other four currencies.

In terms of issuer type, international banks have replaced supranational entities as the most active issuers. Supranational issuers normally have more aggressive issuing targets than international banks. With investor interest increasingly concentrated in the short end of the credit curve, issuance by international banks has more than doubled in the last two years.

The Hong Kong dollar market is primarily a private placement market. Issue size typically is around HK$100 million to HK$200 million. Usually, there is only one arranger taking down the issue from an issuance programme and selling the paper to a small number of investors. The private placement nature of the market means the secondary market has not been very active because:

- a small issue size means there are a small number of investors involved which generally leads to lower liquidity; and

- in a private placement, banks other than the lead managers will not feel obligated to make a market on an issue in which they have no involvement.

In terms of tenor, the market is dominated by three to five year issues, which represent about 65% of total issuance. Tenor longer than seven years only represents 3% of the market. This explains why many Hong Kong issuers have to issue in the US dollar market if they want to obtain long tenor, although almost all of them will enter into a HIBOR/LIBOR basis swap to hedge the US dollar proceeds back to Hong Kong dollars.

Although many investors are prepared to go down the credit curve, the Hong Kong dollar market is still a high investment grade market with single A or better rated issues accounting for 80% of total issuance. It is expected that the Hong Kong dollar market will remain a high-grade market for the foreseeable future.

Institutional Investors
Investors in Hong Kong can broadly be divided into three major categories: the retirement funds, which are commonly referred to in Hong Kong as Mandatory Provident Funds (MPF); the Hong Kong banking institutions; and Hong Kong government-related
The MPF scheme was introduced in December 2000 and covers over 90% of the Hong Kong work force. Under the MPF scheme, both employer and the employee are obligated to contribute amounts equivalent to 5% of the employee’s monthly income (mandatory payments are only due on the first HK$20,000 of monthly salaries, i.e. the maximum mandatory payment for employer and employee is HK$1,000 each per month) to the MPF. The size of the retirement fund market in Hong Kong in mid 2002 was more than HK$200 billion. It is expected that when the scheme is fully mature, the total size of this market will grow by HK$36 billion per year.

Banking institutions are the largest investor category in Hong Kong. The total amount of Hong Kong dollar deposits in the banking system is currently about HK$1.8 trillion. As at Oct 2001, banking institutions in Hong Kong were holding Hong Kong dollar non-government bonds worth about HK$230 billion in their portfolios. Under the banking regulations in Hong Kong, banks have to keep 25% of the deposits accepted by them in liquid assets. Among other things, debt securities are regarded as liquid assets.

Government-related institutional investors include the Housing Authority, the School Fund, the Hospital Authority, etc. Although not strictly a government-related institution, The Hong Kong Jockey Club is also an important Hong Kong dollar investor. The investment subsidiaries of a couple of central banks in the region are also significant buyers of high-grade Hong Kong dollar bonds.

4. Retail Investors

Unlike as is the case in many other markets, in Hong Kong there is currently no overlap between the institutional and the retail markets. Institutional investors do not participate in the retail market due to its tight pricing. Retail investors cannot buy institution-targeted issues due to the large denomination. This contrasts with other public markets where both institutional and retail investors get the same price. In the equity IPO market in Hong Kong, retail investors usually get a better deal than institutional buyers.

Hong Kong Mortgage Corporation continues to be a pioneer in the development of the retail bond market. The corporation has tried a variety of ways to access the retail market some of which have been more successful than others. One of the first strategies was to use stockbrokers to distribute using the equity IPO mechanism. However, this proved to be a costly and ineffective distribution channel. A small group of banks with retail branch networks were then signed up to distribute bonds over the counter. This method was proved to be much more effective as bonds are good substitutes for bank deposits. The number of banks involved in recent retail targeted issues has expanded to more than 10 and the number of branches involved to nearly 500. The introduction of underwriting banks has helped issuers shift a significant amount of market risk to the underwriters.

There are a number of factors contributing to the quick development of the retail market. The current low interest rate environment and a conservative investment attitude are two key influences. Public awareness work and educational campaigns undertaken by the Hong Kong Capital Markets Association is another key element. The increasing awareness of wealth management by banks and their customers and the introduction of investment accounts are helping to make bond purchases over the counter as convenient as buying stocks through brokers. With the removal of the interest rate cartel, banks must now increasingly compete more on non-deposit products and are therefore more eager than before to help selling bonds. In the past, banks were reluctant to sell
bonds as they were regarded as directly competing with deposits.

The Securities and Futures Commission has recently adopted a more “issuer friendly” attitude towards new bond issues. This has made the issuing process much smoother and issuers are now less exposed to market risks. And under the leadership of the Financial Service Bureau, outdated laws governing the issuance of bonds as established in the Companies Ordinance and the Protection of Investors Ordinance are being reviewed.

Industry professionals have welcomed these changes and hope to see additional steps taken by the regulatory authorities to further improve the environment for new bond issues. In particular, we look forward to seeing the prospectus requirements for bond issuance to be made less onerous than those for equity requirements as these two instruments entail very different risks.

Written by Mr. Tony Li
**X. Next Step → Future Direction**

**A. RMB bond market**

Leveraging the competitive advantages mentioned below, the HKMA will continue its efforts to promote and develop the RMB bond market in Hong Kong:

1. abundant supply of RMB liquidity in the offshore market;
2. no restriction on the usage of RMB in the offshore market; and
3. well-developed RMB-related financial infrastructure in Hong Kong

**B. Enhancements to post-trade processing in Asian bond markets**

The HKMA will continue to collaborate with central banks and central securities depositories in the region to improve the post-trade environment in Asia taking into account the specific needs for Asia in terms of cross-border access, of stimulation in local issuance, of automation of post-trade process, of cross-border collateralisation possibility and of reduction in post-trade costs.

**C. G-30 Compliance**

<table>
<thead>
<tr>
<th>Recommendation</th>
<th>Implemented</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Eliminate paper and automate communication, data capture, and enrichment.</td>
<td>No (Paper securities certificates still exist while most of the shares and bonds are safekept in central depositary and can be transfer via book keeping records)</td>
</tr>
<tr>
<td>2. Harmonize messaging standards and communication protocols.</td>
<td>Yes</td>
</tr>
<tr>
<td>3. Develop and implement reference data standards.</td>
<td>Yes (Common data standard such as ISIN and SWIFT BICs are used in local markets)</td>
</tr>
<tr>
<td>4. Synchronize timing between different clearing and settlement systems and associated payment and foreign exchange systems.</td>
<td>No (Real Time Gross Settlement Mode is optional and good payment for normal securities settlement will only be confirmed at next day morning)</td>
</tr>
<tr>
<td>5. Automate and standardize institutional trade matching.</td>
<td>Yes</td>
</tr>
<tr>
<td>6. Expand the use of central counterparties.</td>
<td>Yes (only for settlement for on exchange trades)</td>
</tr>
<tr>
<td>7. Permit securities lending and borrowing to expedite settlement.</td>
<td>Yes</td>
</tr>
<tr>
<td>8. Automate and standardize asset servicing processes, including corporate actions, tax relief arrangements, and restrictions on foreign ownership.</td>
<td>Corporate actions: No Taxation: Not applicable in Hong Kong. Foreign ownership restrictions: Yes.</td>
</tr>
</tbody>
</table>

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9 The G30 recommendations are taken from the Group of Thirty’s report Global Clearing and Settlement – A plan of action (Copyright © 2003 Group of Thirty) [http://www.partad.ru/wrld/word/g30app1.pdf](http://www.partad.ru/wrld/word/g30app1.pdf)
<table>
<thead>
<tr>
<th></th>
<th>Ensure the financial integrity of providers of clearing and settlement services.</th>
<th>Yes</th>
</tr>
</thead>
<tbody>
<tr>
<td>10</td>
<td>Reinforce the risk management practices of users of clearing and settlement service providers.</td>
<td>Yes</td>
</tr>
<tr>
<td>11</td>
<td>Ensure final, simultaneous transfer and availability of assets.</td>
<td>Yes</td>
</tr>
<tr>
<td>12</td>
<td>Ensure effective business continuity and disaster recovery planning.</td>
<td>Yes</td>
</tr>
<tr>
<td>13</td>
<td>Address the possibility of failure of a systematically important institution.</td>
<td>Yes</td>
</tr>
<tr>
<td>14</td>
<td>Strengthen assessment of the enforceability of contracts.</td>
<td>Yes</td>
</tr>
<tr>
<td>15</td>
<td>Advance legal certainty over rights to securities, cash, or collateral.</td>
<td>Yes</td>
</tr>
<tr>
<td>16</td>
<td>Recognize and support improved valuation methodologies and closeout netting arrangements.</td>
<td>Yes</td>
</tr>
<tr>
<td>17</td>
<td>Ensure appointment of appropriately experienced and senior board members (of the boards of securities clearing and settlement infrastructure providers).</td>
<td>Yes</td>
</tr>
<tr>
<td>18</td>
<td>Promote fair access to securities clearing and settlement networks.</td>
<td>Yes</td>
</tr>
<tr>
<td>19</td>
<td>Ensure equitable and effective attention to stakeholder interests.</td>
<td>Yes</td>
</tr>
<tr>
<td>20</td>
<td>Encourage consistent regulation and oversight of securities clearing and settlement service providers.</td>
<td>Yes</td>
</tr>
</tbody>
</table>

D. GOE Barrier Report Market assessment - Hong Kong (April/2010)
[[https://wpqr1.adb.org/LotusQuickr/asean3goe/Main.nsf/h_58E34A1388F9070B48257729000C0A4E/90F408746827C16248257729000C1334/$file/Part3.pdf](https://wpqr1.adb.org/LotusQuickr/asean3goe/Main.nsf/h_58E34A1388F9070B48257729000C0A4E/90F408746827C16248257729000C1334/$file/Part3.pdf)]

<table>
<thead>
<tr>
<th>Potential barrier area</th>
<th>Current situation</th>
<th>Market Assessment Questionnaire scores</th>
<th>Overall barrier assessment</th>
</tr>
</thead>
<tbody>
<tr>
<td>Quotas</td>
<td>There are no quotas on foreign involvement in the local market.</td>
<td>OK</td>
<td>OK</td>
</tr>
<tr>
<td>Investor registration</td>
<td>There are no foreign investor registration requirements.</td>
<td>OK</td>
<td>OK</td>
</tr>
<tr>
<td>FX controls - conversion</td>
<td>There are no exchange control restrictions on residents or non-residents. HKD is freely convertible.</td>
<td>OK</td>
<td>OK</td>
</tr>
<tr>
<td>FX controls - repatriation of funds</td>
<td>There is no restriction on the repatriation of funds.</td>
<td>OK</td>
<td>OK</td>
</tr>
<tr>
<td>Cash controls - credit balances</td>
<td>Non-residents may open accounts in HKD or in foreign currency. Credit balances are allowed.</td>
<td>OK</td>
<td>OK</td>
</tr>
<tr>
<td>Cash controls - overdrafts</td>
<td>Overdrafts are allowed.</td>
<td>OK</td>
<td>OK</td>
</tr>
<tr>
<td>Taxes</td>
<td>There is no withholding tax on any financial instrument. There is no capital gains tax in Hong Kong.</td>
<td>OK</td>
<td>OK</td>
</tr>
<tr>
<td>Omnibus accounts</td>
<td>Omnibus accounts are allowed.</td>
<td>OK</td>
<td>OK</td>
</tr>
<tr>
<td>Potential barrier area</td>
<td>Current situation</td>
<td>Market Assessment Questionnaire scores</td>
<td>Overall barrier assessment</td>
</tr>
<tr>
<td>-----------------------------</td>
<td>-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------</td>
<td>----------------------------------------</td>
<td>-----------------------------</td>
</tr>
<tr>
<td>Settlement cycle</td>
<td>The settlement cycle is T+2 for listed debt securities.</td>
<td>OK</td>
<td>OK</td>
</tr>
<tr>
<td>Message formats</td>
<td>CMU uses SWIFT for settlement messages, and plans to introduce SWIFT for corporate events messages from November 2009. Most local market participants use SWIFT format.</td>
<td>OK</td>
<td>OK</td>
</tr>
<tr>
<td>Securities numbering</td>
<td>ISIN are available for most local bond issues. ISIN are allocated at the time of issue or auction. CMU and local market participants use ISIN, but the local numbering (CMU Issue Number) is also commonly used.</td>
<td>OK</td>
<td>OK</td>
</tr>
<tr>
<td>Matching</td>
<td>There is no trade matching system for the local bond market. CMU pre-matches forward dated settlement instructions.</td>
<td>LOW</td>
<td>LOW</td>
</tr>
<tr>
<td>Dematerialisation</td>
<td>All fixed income instruments are either dematerialised or immobilised at the CSD.</td>
<td>LOW</td>
<td>LOW</td>
</tr>
<tr>
<td>Regulatory framework</td>
<td>The regulatory regime is regarded as stable and consistent and no adverse comments were received in this area.</td>
<td>-</td>
<td>OK</td>
</tr>
</tbody>
</table>
Definitions

The following list presents some of the definitions commonly used in discussion on clearing and settlement topics.

Extract from P.286 BIS Papers No 30 « Clearing, settlement and depository issues »
http://www.bis.org/publ/bppdf/bispap30z.pdf

Clearing. Generally, clearing refers to the process of comparing trades before settlement date or the determination of the net obligations of the broker participants (for both securities and cash). In certain publications, clearing may be used synonymously with settlement.

Settlement. The settlement process refers to the exchange of cash and securities on the contractual settlement date. The settlement date can be agreed upon at trade execution or can be prescribed by local trading conventions. Settlement may be processed on a provisional or a final basis.

Settlement finality. The exchange of cash and securities is final when a settlement can no longer be unwound. Finality eliminates the main legal risks of payment and settlement systems, reduces systemic risk and ensures the smooth operation of a system.

Gross settlement. Gross settlement systems settle transactions on an instruction by instruction and real-time (RTGS) basis throughout the day. RTGS systems are costly due to the need for collateral or available cash balances to cover payment obligations during the day or for securities lending programmes to cover short securities positions. RTGS systems, however, typically reduce systemic risk.

Net settlement. In net settlement systems, obligations are settled at the end of the business day on a net basis. The net process is subject to potential systemic risk, due to the contagion effect where incoming funds are relied upon to make onward payments when a participant cannot meet his obligations. As there is no requirement to post collateral or keep cash balances readily available during the day, net systems tend to be less costly.

Central securities depository (CSD). A CSD is either the physical entity or the system that facilitates the settlement and safekeeping of securities and ensures the reconciliation of participant accounts. Securities can be safekept in immobilised or dematerialised form. Settlement generally occurs in book entry form.

International central securities depository (ICSD). An ICSD is a depository settling trades in international and various domestic securities, usually through direct and indirect links with agents in the domestic markets. The best known ICSDs are Euroclear Bank and Clearstream International. The eurobond market developed in part in response to operational and regulatory inefficiencies in domestic bond markets.

Central counterparty (CCP). A CCP acts as counterparty to every buy and sell trade, a process known as “novation”. This process concentrates counterparty risk and provides multilateral netting.
Contributors to the making of this market guide

- Mr Raymond Bo  Hong Kong Monetary Authority
- Market Profile provided by Citi
- Deutsche Bank Domestic Custody Services, Market Guide Vietnam, July 2009
- SLAUGHTER AND MAY

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Mobile: +81-(0)80-3360-7551
E-Mail: shige.inukai@river.dti.ne.jp
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   C. Conclusion

V. High level description of the securities settlement system
   A. Securities settlement infrastructure
   B. Definition of Clearing and settlement
   C. Challenges/ Expected changes

VI. Cost and charging methods
   A. Maintenance (on-going) Costs
   B. Initial Fees

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   A. Equity market
   B. FCY bond market
   C. Market size

VIII. Presence of an Islamic Finance (Islamic bond (Sukuk)) market
   A. Regulatory framework for Islamic Finance in general
   B. Type of instruments available, segments, tenure, e.g.
   C. Basic Market infrastructure required to facilitate Islamic Finance
   D. Tax related issues

IX. History of Debt Market development
X. Next Step → Future Direction
   A. Bond market
   B. Enhancements to post-trade processing in Asian bond markets
C. G-30 Compliance
D. GOE Barrier Report Market assessment - Philippines
I. High Level Structure, Type & Characteristics of the Market

A. Types of Bonds

1. By issuer category
   a. Bonds issued by public entities
      i. Government securities
      ii. Government-owned or controlled corporations (GOCCs)¹
   b. Bonds issued by private entities
      i. Financial institutions
      ii. Local corporates
      iii. Multilateral development banks (MDB)
      iv. Non-MDB offshore borrowers

2. By type of bonds
   a. Straight Bonds (Government Bonds/Corporate Bonds)
   b. Zero-coupon Bonds
   c. Unsubordinated debt securities

3. Money Markets instruments
   a. Certificate of Deposit
   b. Commercial Paper

4. By listing status
   a. Debt Securities Listed on Philippine Dealing System (PDEx)
   b. Bonds non-listed, can be traded over-the-counter (OTC)

B. Methods of Issuing Bonds

1. Government bonds

   Government bonds are issued via competitive auction by Bank Negara Malaysia on behalf of the government. Successful bidders are determined according to the lowest yields offered and the coupon rate is fixed at the weighted average yield of successful bids.

2. Bonds issued by government-owned or controlled corporations
   Methods are similar to those of issuing corporate bonds stated below.

¹ List of GOCCs based from the records of Commission on Audit (http://www.coa.gov.ph/Links/links-goccs.asp)
3. Methods of issuing Corporate Bonds

Private entities generally adopt one of the following methods to issue corporate bonds:

a. Public offer for bonds intended to sell to the public; or
b. Private placement for bonds intended to sell to a small group of investors.

C. Credit-Rating Agencies and Credit Rating of Bonds

PhilRatings is the only accredited local credit rating agency of the Bangko Sentral ng Pilipinas (BSP) and the rating agency is also an affiliate of Standard and Poor's. A basic profile of PhilRatings can be found by following the link (http://www.philratings.com).

Government and government-guaranteed debt securities are exempt from local credit ratings. However, the Securities and Exchange Commission (SEC) requires issuers of commercial paper and bonds to obtain credit ratings from the Philippine Rating Service Corporation (PhilRatings) or from any internationally-accepted credit rating agency with a representative office in the Philippines.

In January 2011, Moody's Investors Service changed the outlook on the government of the Philippines' Ba3 foreign currency (FCY) and LCY bond ratings to positive from stable on the back of the Philippines’ (i) strengthening trend in its external payments position, (ii) successful conduct of monetary policy, and (iii) improved prospects for economic reform policies. Also in January, Fitch Ratings affirmed the sovereign credit ratings of the Philippines at BB for its FCY long-term issuer default rating and BB+ for its long-term LCY issuer default rating and country ceiling. Fitch Ratings also affirmed its stable outlook for the Philippines.

D. Bond Related Systems for Investor Protections (Disclosure)

E. Governing laws of bond issuance

Generally, all publicly-offered securities must be registered with the Securities and Exchange Commission (SEC). Exemptions are granted for securities issued by the Government, Bangko Sentral ng Pilipinas (BSP), local government units, and any foreign government that has diplomatic relations with the Philippines.

A credit rating from the Philippine Rating Service Corporation (PhilRatings), or any BSP-recognized credit rating agency, is required to issue corporate bonds and commercial paper. Generally, all foreign-denominated debt instruments must be registered with the BSP.

F. Transfers of interests in bonds

a) Register of Bondholders

The Issuer shall cause the Register of Bondholders to be kept by the Registrar, in electronic form. The names and addresses of the Bondholders and the particulars of the Bonds held by them and of all transfers of Bonds shall be entered into the Register of Bondholders. As required by Circular No. 428-04 issued by the Bangko Sentral ng Pilipinas, the Registrar shall send each Bondholder a written statement of registry holdings at least quarterly (at the cost of the Issuer), and a written advice confirming every receipt or transfer of the Bonds that is
effected in the Registrar’s system (at the cost of the relevant Bondholder). Such statement of registry holdings shall serve as the confirmation of ownership of the relevant Bondholder as of the date thereof. Any and/or all requests of Bondholders for certifications, reports or other documents from the Registrar, except as provided herein, shall be for the account of the requesting Bondholder.

b) Transfers; Tax Status
Bondholders may transfer their Bonds at anytime, regardless of tax status of the transfer or vis-à-vis the transferee. Should a transfer between Bondholders of different tax status occur on a day which is not an Interest Payment Date, tax exempt entities trading with non tax exempt entities shall be treated as non-tax exempt entities for the interest period within which such transfer occurred. A Bondholder claiming tax-exempt status is required to submit a written notification of the sale or purchase to the Trustee and the Registrar, including the tax status of the transferor or transferee, as appropriate, together with the supporting documents specified below under “Payment of Additional Amounts; Taxation”, within three days of such transfer.

c) Secondary Trading of the Bonds
The Issuer intends to list the Bonds in PDEx for secondary market trading or such other securities exchange as may be licensed as such by the PSE on which the trading of debt securities in significant volumes occurs. Secondary market trading in PDEx shall follow the applicable PDEx rules and conventions, among others, rules and conventions on trading and settlement. Upon listing of the Bonds with PDEx, investors shall course their secondary market trades through PDEx Brokering Participants for execution in the PDEx Public Market Trading Platform in accordance with PDEx Trading Rules, Conventions and Guidelines, and shall settle such trades on a Delivery versus Payment (DvP) basis in accordance with PDEx Settlement Rules and Guidelines. The PDEx rules and conventions are available at the PDEx website (www.pdex.com.ph). An Investor Frequently Asked Questions (FAQ) discussion on the secondary market trading, settlement, documentation and estimated fees are also available in the PDEx website.

G. Definition of securities

Section 3, SRC

According to the Securities Regulation Code (SRC), securities are shares, participation or interests in a corporation or in a commercial enterprise or profit-making venture and evidenced by a certificate, contract, instrument, whether written or electronic in character. It includes:

(a) Shares of stock, bonds, debentures, notes, evidences of indebtedness, asset-backed securities;
(b) Investment contracts, certificates of interest or participation in a profit sharing agreement, certificates of deposit for a future subscription;
(c) Fractional undivided interests in oil, gas or other mineral rights;
(d) Derivatives like option and warrants;
(e) Certificates of assignments, certificates of participation, trust certificates, voting trust certificates or similar instruments;
(f) Proprietary or non proprietary membership certificates incorporations; and
(g) Other instruments as may in the future be determined by the Commission.²

The definition under the SRC focuses on security as an equity or investment instrument, but the examples by way of enumeration includes debt instruments, e.g. bonds, debentures, notes, evidences of indebtedness.

* On the other hand, the old **Revised Securities Act (RSA)** defined securities as bonds, debentures, notes, evidences of indebtedness, shares in a company, pre-organization certificates or subscriptions, investment contracts, certificates of interest or participation in a profit sharing agreement, collateral trust certificates, equipment trust certificates (including conditional sale contracts or similar interests or instruments serving the same purpose), voting trust certificates, certificates of deposit for a security, or fractional undivided interest in oil, gas, or other mineral rights, or, in general, interests or instruments commonly considered to be "securities", or certificates of interests or participation in, temporary or interim certificates for, receipts for, guarantees of, or warrants or rights to subscribe to or buy or sell any of the foregoing; or commercial papers evidencing indebtedness of any person, financial or non-financial entity, irrespective of maturity, issued, endorsed, sold, transferred or in any manner conveyed to another, with or without recourse, such as promissory notes, repurchase agreements, certificates of assignments, certificates of participation, trust certificates or similar instruments; or proprietary or non-proprietary membership certificates, commodity futures contracts, transferable stock options, pre-need plans, pension plans, life plans, joint venture contracts, and similar contracts and investments where there is no tangible return on investments plus profits but an appreciation of capital as well as enjoyment of particular privileges and services.³ The RSA was superseded by the RSC in 2000. It is interesting to note, though, that the RSA was broader in scope in the definition of securities, encompassing both equity and debt instruments.

* The **Glossary of Terms** issued by Philippine Dealing & Exchange Corp. (PDEx) characterizes corporate securities as **Equity Securities and/or Debt Securities** issued by a private Issuer. Debt securities are notes, bills of exchange, bonds, debentures, commercial papers, and other evidences of indebtedness which are considered as Securities while equity securities are shares of stock of any class, certificates of participation, warrants, options or other rights, and other evidences of undivided ownership interest in a corporation.⁴ According to SRC Rule 18.1, equity securities are securities which provide the holder thereof with voting rights and shall not include convertible securities and other derivatives except as provided in the definition of beneficial owner in SRC Rule 3

### H. Self-governing rules behind the market

#### I. Bankruptcy procedures

The Civil Code is the primary law governing insolvency in the Philippines. Special laws can

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² **SECURITIES REGULATION CODE, REPUBLIC ACT NO. 8799, § 3.1 (2000).**
³ **THE REVISED SECURITIES ACT, BATAS PAMBANSA BLG. 178, § 2 (a) (1982).**
govern insolvency as long as they are not inconsistent with the code. These special laws include the Insolvency Law and Presidential Decree 902-A (http://www.insolvencyasia.com/insolvency_law_regimes/philippine/section_i.html).

The Insolvency Law covers suspension of payments along with voluntary and involuntary insolvencies. Presidential Decree No. 902-A gives the Securities and Exchange Commission (SEC) jurisdiction over petitions for the suspension of payments.

J. Meetings of bondholders

A meeting of the Bondholders may be called at any time for the purpose of taking any actions authorized to be taken by or on behalf of the Bondholders of any specified aggregate principal amount of Bonds under any other provisions of the Trust Indenture or under the law and such other matters related to the rights and interests of the Bondholders under the Bonds.

a) Notice of Meetings
The Trustee may at any time call a meeting of the Bondholders, or the holders of at least twenty-five percent (25%) of the aggregate outstanding principal amount of Bonds may direct in writing the Trustee to call a meeting of the Bondholders, to take up any allowed action, to be held at such time and at such place as the Trustee shall determine. Notice of every meeting of the Bondholders, setting forth the time and place of such meeting and the purpose of such meeting in reasonable detail, shall be sent by the Trustee to the Issuer and to each of the registered Bondholders not earlier than forty five (45) days nor later than fifteen (15) days prior to the date fixed for the meeting. Each of such notices shall be published in a newspaper of general circulation as provided in the Trust Indenture. All reasonable costs and expenses incurred by the Trustee for the proper dissemination of the requested meeting shall be reimbursed by the Issuer within ten (10) days from receipt of the duly supported billing statement.

b) Failure of the Trustee to Call a Meeting
In case at any time the Issuer or the holders of at least twenty five percent (25%) of the aggregate outstanding principal amount of the Bonds shall have requested the Trustee to call a meeting of the Bondholders by written request setting forth in reasonable detail the purpose of the meeting, and the Trustee shall not have mailed and published, in accordance with the notice requirements, the notice of such meeting, then the Issuer or the Bondholders in the amount above specified may determine the time and place for such meeting and may call such meeting by mailing and publishing notice thereof.

c) Quorum
The Trustee shall determine and record the presence of the Majority Bondholders, personally or by proxy. The presence of the Majority Bondholders shall be necessary to constitute a quorum to do business at any meeting of the Bondholders.

d) Procedure for Meetings
a. The Trustee shall preside at all the meetings of the Bondholders, unless the meeting shall have been called by the Issuer or by the Bondholders, in which case the Issuer or the Bondholders calling the meeting, as the case may be, shall in like manner move for the election of the chairman and secretary of the meeting.

b. Any meeting of the Bondholders duly called may be adjourned for a period or periods not to exceed in the aggregate of one (1) year from the date for which the meeting shall originally have been called and the meeting as so adjourned may be held without further notice. Any such adjournment may be ordered by persons representing a majority of the aggregate principal amount of the Bonds represented at the meeting and entitled to vote, whether or not
a quorum shall be present at the meeting.

e) Voting Rights
To be entitled to vote at any meeting of the Bondholders, a person shall be a registered holder of one (1) or more Bonds or a person appointed by an instrument in writing as proxy by any such holder as of the date of the said meeting. Bondholders shall be entitled to one vote for every Ten Thousand Pesos (P10,000.00) interest. The only persons who shall be entitled to be present or to speak at any meeting of the Bondholders shall be the persons entitled to vote at such meeting and any representatives of the Issuer and its legal counsel.

f) Voting Requirement
All matters presented for resolution by the Bondholders in a meeting duly called for the purpose shall be decided or approved by the affirmative vote of the Majority Bondholders present or represented in a meeting at which there is a quorum except as otherwise provided in the Trust Indenture (please refer to the preceding discussion on “Quorum”). Any resolution of the Bondholders which has been duly approved with the required number of votes of the Bondholders as herein provided in the Trust Indenture shall be binding upon all the Bondholders and the Issuer as if the votes were unanimous.

g) Role of the Trustee in Meetings of the Bondholders
Notwithstanding any other provisions of the Trust Indenture, the Trustee may make such reasonable regulations as it may deem advisable for any meeting of the Bondholders, in regard to proof of ownership of the Bonds, the appointment of proxies by registered holders of the Bonds, the election of the chairman and the secretary, the appointment and duties of inspectors of votes, the submission and examination of proxies, certificates and other evidence of the right to vote and such other matters concerning the conduct of the meeting as it shall deem fit.

K. Event of default

The Issuer shall be considered in default under the Bonds and the Trust Indenture in case any of the following events (each an “Event of Default”) shall occur and is continuing:

a) The Issuer fails to pay any principal and/or interest due on the Bonds.
b) Any representation and warranty of the Issuer or any certificate or opinion submitted by the Issuer in connection with the issuance of the Bonds is untrue, incorrect, or misleading in any material respect.
c) The Issuer fails to perform or violates its covenants under the Bonds, and such failure or violation is not remediable or, if remediable, continues to be unremedied for a period of 30 days from notice by the Trustee to the Issuer.
d) The Issuer is:
   i. in breach of any term or condition of any contract executed by the Issuer with any other bank, financial institution, or other person, corporation, or entity for the payment of moneys which constitutes an event of default under said contract, or
   ii. in violation of any law or regulation, and which events of default or violation under i or ii above:
      • if remediable, are not remedied by the party involved within 30 days from notice by the Trustee to the Issuer, or are otherwise not contested by the Issuer, and
      • result in the acceleration or declaration of the whole obligation to be due and payable prior to the stated normal date of maturity, which obligation exceeds $10,000,000.00 or its equivalent in any other currency; and
will, in the reasonable opinion of the Trustee, adversely and materially affect
the performance by the Issuer of its obligations under the Bonds or pay any
amount outstanding on the Bonds.

e) Any final and executory judgment, decree, or arbitral award for the sum of money,
damages, fine, or penalty which would in the reasonable opinion of the Trustee, adversely
and materially affect the performance by the Issuer of its obligations under the Bonds or pay
any amount outstanding on the Bonds.

f) The government or any competent authority takes any action to revoke, suspend, or
terminate the whole or a material portion of the license or operations of the Issuer or,
condemns, seizes, or expropriates all or substantially all of the assets or properties of the
Issuer, unless such act is contested in good faith by the Issuer unless such act is suspended
or restrained by an order of a court of competent jurisdiction.

g) Any judgment, writ, warrant of attachment or execution, or similar process shall be issued
or levied against all or substantially all of the Issuer’s assets and such judgment, writ, warrant,
or similar process shall not be released, vacated, or fully bonded within 30 days after its issue
or levy.

h) The Issuer voluntarily suspends or ceases operations of a substantial portion of its
business for a continuous period of 30 days, except in the case of strikes or lockouts when
necessary to prevent business losses, or when due to fortuitous events or force majeure, or
when there is no material adverse effect on the business operations or financial condition of
the Issuer.

i) The Issuer becomes insolvent or is unable to pay its debts when due or commits or permits
any act of bankruptcy, including (i) filing of a petition in any bankruptcy, reorganization,
winding-up, suspension of payment, liquidation, or other analogous proceeding; (ii)
appointment of a trustee or receiver of all or a substantial portion of its properties; (iii) making
of an assignment for the benefit of its creditors of all or substantially all of its properties; (iv)
admission in writing of its general inability to pay all of its debts; or (v) entry of any order or
judgment of any court, tribunal, or administrative agency or body confirming the insolvency of
the Issuer, or approving any reorganization, winding-up, liquidation, or appointment of trustee
or receiver of the Issuer or a substantial portion of its property or assets.

L. Options available on the bond market

1. Currency

The most common currencies in which bonds are denominated are: PHP, USD and EUR.

2. Retail bonds

a. Retail Treasury Bonds (RTBs) are direct and unconditional obligations of the
national government which primarily caters to the retail market or the end-users.
They are issued by the Bureau of Treasury (BTr). They are interest bearing and
carry a term of more than one year and can be traded in the secondary market
before maturity.

b. Retail Treasury Bonds are issued and sold at a price equal to be face value and are
redeemed at maturity for the full face value of the instrument plus interest/coupon of
the last period.

M. Parties involved in a bond issue and their respective roles

1. Exchanges, SROs, Clearing Agencies, Depository
Exchange is an organized marketplace or facility that brings together buyers and sellers, and executes trades of securities and/or commodities. Self-Regulatory Organization, or SRO, means an organized Exchange, registered clearing agency, organization or association registered as an SRO under Section 39 of the Code.

2. Broker/Dealer

3. Registered Salesperson

4. Registered Associated Person

5. Investment Company Adviser

6. Transfer Agents
   Transfer agent is any person who performs on behalf of an Issuer or by itself as Issuer any of the following activities:
   (i) countersigns, when applicable, certificates of securities upon their issuance;
   (ii) monitors the issuance of securities to prevent unauthorized issuances;
   (iii) registers the transfer of such securities;
   (iv) exchanges or converts such securities;
   (v) records the ownership of securities by bookkeeping entry without physical issuance of securities certificates.

7. Lending Agents for SBL

8. Investment Houses

9. Underwriter of Securities

10. Dealers in Government Securities

11. Registrars of Qualified Buyers

Details under each item can be found in this link:

N. Major Players in the Market

1. Issuer
   a. Government
      The Government is the largest issuer of debt. The Government may also assume or guarantee all or part of domestic debt issued by government-owned institutions. For example, the Home Development Mutual Fund, also known as Pag-IBIG, issues bonds to finance its housing loan program.

   b. Corporates and Financial Institutions
      Leading Philippine corporates and financial institutions dominate the private debt market. They are by far the largest issuers of commercial papers and subordinated bonds.

   c. Supranational
      The Asian Development Bank (ADB) was also the first supranational issuer in Philippine domestic capital markets. ADB programs finances development projects and programs within developing member countries with the aim of reducing poverty in the Asia and
Pacific region. ADB undertakes most of its borrowing through its Global Medium Term Note Program, which was established in 2001.

2. Investor

Government agencies and GOCCs are the major holders of government bonds. Other investors include private corporations, banks, retail investors, and asset pooling industries—including pension funds, insurance companies, and asset management companies.

a. Government

Government agencies and government-owned and controlled corporations—such as the PAG-IBIG Fund, Development Bank of the Philippines, and Bangko Sentral ng Pilipinas (BSP)—invest a portion of their holdings in fixed-income assets.

b. Pension Fund

The Government Service Insurance System (GSIS) and the Social Security System (SSS) are the largest government pension funds. GSIS and SSS are welfare systems for private and corporate employees, respectively. Conservative government investment policies limit investments to government debt securities and shares of leading Philippine companies. Other government pension fund systems, such as the Armed Forces of the Philippines Retirement and Separation Benefit System, invest a part of their portfolios in government bonds and selected commercial paper.

In additional to government funds, there are 33 active pre-need companies offering pension, educational, and interment plans. The Securities and Exchange Commission (SEC) restricts a portion of pre-need investment portfolios to fixed-income securities.

c. Insurance Companies

There are 32 life insurance firms licensed to operate in the Philippines. Insurance companies like Ayala Life Assurance Incorporated; Philam Insurance Company, Inc.; Sun Life Financial; and The Manufacturers Life Insurance Co. (Phils.), Inc. are major investors in government bonds and commercial paper.

d. Asset Management

The mutual fund industry in the Philippines is the least developed in Asia. Growth in the industry is restricted by a narrow investor base in which only a few institutional investors participate in the local bond market. There are only three major participants: Philam Asset Management, Sunlife Asset Management, and Bank of the Philippine Islands (BPI) Asset Management and Trust Group.

II. Primary and secondary market regulatory frameworks

A. Philippine Market Regulatory Structure

Local and foreign investors may invest in the Philippine bond market. To protect investors, the Insolvency Law and Civil Code provide details on bondholder rights. Guidelines on cross-border portfolio investment are issued by the Bangko Sentral ng Pilipinas (BSP).

1. Bangko Sentral ng Pilipinas

The Bangko Sentral ng Pilipinas (BSP) supervises banks and non-bank financial institutions that perform quasi-banking functions. BSP supervises the registration of foreign investments in the country and monitors the inflow and outflow of capital.
2. Securities Commission

The Securities and Exchange Commission (SEC) regulates both primary and secondary debt markets; and oversees the Philippine Stock Exchange, the three subsidiaries of the Philippine Dealing Systems Holdings Corp., brokers, registrars, transfer agents, and clearinghouses.

3. Department of Finance and Bureau of the Treasury

The Department of Finance (DOF) regulates issuance of government securities in the market while the DOF's Bureau of the Treasury operates and monitors daily debt market activity.

4. Philippine Dealing System Holdings Corporation (PDS Group)

The PDS Group manages the country's first electronic platform for trading, clearing, settlement, depository, registry, and custody of fixed-income securities and derivatives. The PDS Group has three operating subsidiaries: (i) Philippine Dealing & Exchange Corp (PDEx)—an entity that operates electronic trading platforms for securities; (ii) Philippine Depository & Trust Corp. (PDTC)—an entity that provides securities depository, registry, and custody services; and (iii) Philippine Securities Settlement Corporation (PSSC)—the company that provides electronic settlement facilities with straight-through process and delivery-versus-payment capabilities. PSSC is responsible for matching, and clearing and settlement; with PDTC handling depository and custodianship of fixed-income securities and derivatives. For more details, refer to this link: http://www.pdex.com.ph/.

B. Regulation of the Philippine securities markets

1. Rough legislative framework

   The Securities and Exchange Commission (SEC) regulates both primary and secondary debt markets; and oversees the Philippine Stock Exchange, the three subsidiaries of the Philippine Dealing Systems Holdings Corp., brokers, registrars, transfer agents, and clearinghouses.

   Under Section 5 of the Securities Regulation Code, Rep. Act. 8799, the Commission shall have, among others, the following powers and functions:

   (a) Have jurisdiction and supervision over all corporations, partnerships or associations who are the grantees of primary franchises and/or a license or permit issued by the Government;

   (b) Formulate policies and recommendations on issues concerning the securities market, advise Congress and other government agencies on all aspects of the securities market and propose legislation and amendments thereto;

   (c) Approve, reject, suspend, revoke or require amendments to registration statements, and registration and licensing applications;

   (d) Regulate, investigate or supervise the activities of persons to ensure compliance;

   (e) Supervise, monitor, suspend or take over the activities of exchanges, clearing agencies and other SROs;
(f) Impose sanctions for the violation of laws and the rules, regulations and orders issued pursuant thereto;

(g) Prepare, approve, amend or repeal rules, regulations and orders, and issue opinions and provide guidance on and supervise compliance with such rules, regulations and orders;

(h) Enlist the aid and support of and/or deputize any and all enforcement agencies of the Government, civil or military as well as any private institution, corporation, firm, association or person in the implementation of its powers and functions under this Code;

(i) Issue cease and desist orders to prevent fraud or injury to the investing public;

(j) Punish for contempt of the Commission, both direct and indirect, in accordance with the pertinent provisions of and penalties prescribed by the Rules of Court;

(k) Compel the officers of any registered corporation or association to call meetings of stockholders or members thereof under its supervision;

(l) Issue *subpoena duces tecum* and summon witnesses to appear in any proceedings of the Commission and in appropriate cases, order the examination, search and seizure of all documents, papers, files and records, tax returns, and books of accounts of any entity or person under investigation as may be necessary for the proper disposition of the cases before it, subject to the provisions of existing laws;

(m) Suspend, or revoke, after proper notice and hearing the franchise or certificate of registration of corporations, partnerships or associations, upon any of the grounds provided by law; and

(n) Exercise such other powers as may be provided by law as well as those which may be implied from, or which are necessary or incidental to the carrying out of, the express powers granted the Commission to achieve the objectives and purposes of these laws

2. Trading Rights

A Trading Participant shall be any person that has been qualified to trade on the PDEEx Trading System. There are 3 types of trading participants. These are:

1. Dealing Participants, who may be Market-Making Participants as defined below;

2. Qualified Investor Participants who may opt not to be members of the Self Regulatory Organization, hence not bound by these Rules but bound by the pertinent agreements; and


Detailed information are in the PDEEx Rules for the Fixed Income Securities Market, as Amended (Revised - 03 March 2011) (http://203.177.79.3/customer/pdex/PDEEx%20Rules%20for%20the%20Fixed%20Income%20Securities%20Market,%20as%20Amended%20(Revised%20-%2003%20March%202011).pdf)
C. Issuing debt instruments related regulations / rules

Generally, all publicly-offered securities must be registered with the Securities and Exchange Commission (SEC). Exemptions are granted for securities issued by the Government, Bangko Sentral ng Pilipinas (BSP), local government units, and any foreign government that has diplomatic relations with the Philippines.

A credit rating from the Philippine Rating Service Corporation (PhilRatings), or any BSP-recognized credit rating agency, is required to issue corporate bonds and commercial paper.

Generally, all foreign-denominated debt instruments must be registered with the BSP.

http://www.sec.gov.ph/irr/AmendedIRR.pdf

D. Buying debt instruments related regulations / rules (Investment in debt securities)

1. For retail investors, the Bureau of the Treasury issues retail treasury bonds in varying amounts at a minimum denomination of PHP5,000. Individual investors interested in purchasing retail treasury bonds can apply through any government securities eligible dealer (GSED) to receive information on opening a transaction account. Some GSEDs may require a higher minimum investment.

2. The Money Market Association of the Philippines (MART) provides a list of the basic requirements for opening an individual transaction account; and an explanation on the basics of investing, investor rights, and obligations (http://www.mart.com.ph/representations.php).

3. In the case of foreign investors, there are no restrictions on foreigners purchasing bonds, money-market instruments, or other portfolio investments. Non-residents seeking to invest in the local stock or bond markets are required to finance their transactions through inward foreign exchange remittances or from withdrawals against their foreign currency accounts. They must effect transactions through an authorized security dealer or broker licensed by the Securities Exchange Commission (SEC) or a bona fide member of the Philippine Stock Exchange. Transactions can be carried out either locally or abroad.

E. Investor Protection

1. Bondholders Rights
   The Insolvency Law and Civil Code cover bondholder rights. Claims of creditors against debtors through insolvency proceedings fall under the Insolvency Law. The Civil Code prescribes the order of payments to different types of creditors in the event of liquidation of a debtor’s estate. The same rules apply to domestic and foreign bondholders.

2. Prevention of Fraud
   The Securities Regulation Code (SRC) prohibits fraudulent and manipulative transactions. Refer to this link for more details: http://www.sec.gov.ph/irr/AmendedIRR.pdf

F. Taxation Framework and Tax requirements
Under the Tax Reform Act (Republic Act 8424), interest income from Philippine peso-denominated government or corporate debt securities is subject to a 20% final withholding tax. The withholding tax rate applies to both resident and non-resident aliens engaged in trade or business in the country. Government securities are exempt from capital gains tax, while a 5–10% tax rate is levied on other debt securities.

In February 2004, a new Documentary Stamp Tax Bill (R.A. 9243) was passed that temporarily waived document stamp taxes levied on secondary trading of debt and equity instruments, and on borrowing or lending securities traded at a registered exchange.

<table>
<thead>
<tr>
<th>Type of Bonds</th>
<th>Resident Investors and Nonresident Investors</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Interest Income</td>
</tr>
<tr>
<td>Government &amp; Quasi Government Bonds</td>
<td>Subject to 20% final withholding tax.</td>
</tr>
<tr>
<td>Corporate Bonds &amp; Commercial Paper</td>
<td>Standard rate of withholding tax on income payments from corporate bonds is 30%.</td>
</tr>
<tr>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
</tr>
</tbody>
</table>

G. Offers of bonds to professionals

H. Definition of “professional investors” in the HKSAR(Special Administrative Region)

I. Challenges / Expected changes

III. Trading of Bonds and Trading Market Infrastructure

A. Exchange trading

The Philippine Dealing and Exchange Corp (PDEx) is licensed by the Securities and Exchange Commission (SEC) as an Exchange under the provisions of the Securities Regulation Code (SRC). In this capacity, PDEx provides a centralized & efficient infrastructure for trading securities which ensures price discovery, transparency and investor protection. In July 2006, SEC formally recognized PDEx as a Self-Regulatory Organization (SRO) in the Inter-Dealer Market and is thus vested with the responsibility of formulating the requisite market rules, undertaking surveillance and enforcing compliance in the inter-dealer market. In November 2007, the SEC expanded the SRO registration of PDEx to cover the Inter-Professional Market, and in February 2008, its SRO authority was expanded to cover its members in all markets within the PDEx Trading Systems.

B. OTC market trading

Over-the-Counter (OTC) is another mode of originating GS for specific investors, namely, the Government Owned or Controlled Corporations (GOCC), the Local Government Units (LGU)
and the Tax Exempt Institutions (TEI), e.g., pension funds, GSIS, SSS, etc. The Over-the-Counter is open every day and is non-competitive. The applicable yield rates for Treasury Bills issued to GOCCs/LGUs/TEIs shall be based on the rate of the immediately preceding Treasury Bill auction. For GOCCs, the rate shall be the lowest accepted yield rate, for LGUs, the weighted average yield rate and for TEIs, the yield shall be 90% of the weighted average yield rate. Treasury Bonds issued to GOCCs/LGUs/TEIs shall be priced based on the current market yield. The coupon rate for GOCCs and LGUs shall be based on the rate corresponding to the auctioned Treasury Bonds. The applicable coupon rate for TEIs shall be based on the 90% of the coupon rate.

IV. Possible item of Impediments / Restrictions

A. Repo market
B. Liquidity in the secondary market
C. RMB denominated bond market
D. Conclusion

V. High level description of the securities settlement system

A. Securities settlement infrastructure

Government securities are registered and cleared through an automated registry system—the Registry of Scripless Securities (RoSS)—administered by the Bureau of the Treasury. Trade settlements are referred to the Bangko Sentral ng Pilipinas (BSP).

The Philippine Payments and Settlements System (PhilPaSS) handles the processing and final settlement of fund transfer instructions in real time. PhilPaSS is a gross settlement system in which transfers are settled individually without netting debits against credit. As it is also a real time settlement system, PhilPaSS effects final settlement continuously rather than periodically at pre-specified times, provided that a sending bank has sufficient balances or credit. The settlement process is based on the real time transfer of funds from the BSP.

There is no central clearing system for corporate bonds. Clearing is conducted through a delivery, versus payment, system between concerned institutions. However, some recent corporate bond issues were settled through the Philippine Central Depository, which is normally used by the equities market.

B. Definition of Clearing and settlement

1. Clearing
   a. It is the process of determining accountability and creating obligations for the exchange of the Security Element and/or the Cash Element between counterparties to a Transaction.\(^5\)
   b. Clearing/clearance is the process of transmitting, reconciling and, in some cases, confirming payment orders or security transfer instructions prior to settlement, possibly including the netting of instructions and the establishment of final positions for

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settlement. Sometimes the term is used (imprecisely) to include settlement.\textsuperscript{6}

2. Settlement
   a. It is an act that discharges obligations in respect of funds or securities transfers between two or more parties.\textsuperscript{7}
   b. Settlement is the completion of a transaction, wherein the seller transfers securities or financial instruments to the buyer and the buyer transfers money to the seller. A settlement may be final or provisional.\textsuperscript{8}
   c. Settlement means the completion of a Transaction through the Philippine Depository and Trust Corporation (PDTC) System effected by the delivery of the Securities Element and/or the payment of the Cash Element in the quantity or amount determined by the Clearing of the Transaction. The terms "settle", "settled" and "settling" when used in these PDTC Rules shall refer to the verb or adjective forms of Settlement, as the context may imply.\textsuperscript{9}

C. Challenges/ Expected changes

VI. Cost and charging methods

The consolidated schedule of fees and charges to be imposed and collected by the Securities and Exchange Commission can be found at www.sec.gov.ph.
Ⅶ. Market size / statistics

A. Market size

The size of the Philippines' local currency (LCY) bond market rose 9.4% year-on-year (y-o-y), with total volume reaching PHP3.2 trillion (USD72.8 billion) as of end-December, buoyed primarily by government borrowing. Compared with 3Q10, total LCY bonds outstanding in 4Q10 were relatively unchanged and registered only 0.2% quarter-on-quarter (q-o-q) growth as a lack of issuance in the corporate sector offset the increase in government LCY bonds.

Total LCY government bonds outstanding rose 10.1% y-o-y to PHP2.8 trillion (USD64.3 billion) as of end-December, driven by a surge in treasury bonds of 17.5% y-o-y in 4Q10, as the government lengthened its debt maturity profile with a debt exchange program. Corporate sector bonds outstanding grew by 4.8% y-o-y. Meanwhile, treasury bills outstanding declined by 15.2% y-o-y to close the year at PHP527 billion (USD12 billion).

B. Foreign-currency (FCY) bond market

In the recent years, the Philippines has been one of the most active borrowers to the international debt market in the region due to its lower borrowing cost. Several USD-denominated bonds have been issued by the central government, GOCCs and corporates in the past. Moreover, the government sold JPY100 billion worth of 10-year samurai bonds in February 2010, via private placement and with a guarantee from the state-backed Japan Bank for International Cooperation (JBIC) for up to 95% of the bonds under its Japanese Market Access Support Facility. Also, the government, thru the Bureau of the Treasury (BTr), sold USD350 million worth of multicurrency retail bonds to overseas Filipino workers in April 2010. As of end-2010, the total FCY bonds outstanding amounted to $39.3 billion, of which 83% are issued by the central government, 13% from corporates and the remaining 4% from the banks and financial institutions.

C. Equity market

As of December 31, 2010, the Philippine Stock Exchange (PSE) had 253 listed companies with a total market capitalization of $202 billion. There are also 184 trading participants registered at the PSE, of which 132 are active.
Ⅷ. Presence of an Islamic Finance (Islamic bond (Sukuk)) market

Not available in the Philippines.
IX. History of Debt Market Development

Interest rates are market determined and have trended downward during the 1990s, as inflation was brought under control and fiscal deficits were reduced. Commercial bank deposit rates fell from 20% in 1990 to just under 10% in 1997. Adjusted for inflation, savers received positive deposit rates for each year of the period at approximately 3% with no clear trend.

A few large commercial banks dominate the Philippine financial market. They are the major players in the Philippine equities, bond, and foreign exchange markets. Until 1993 the relative importance of bonds and bank assets (loans) was greater than that of equities. During 1988–92, the value of bonds outstanding represented 28% of GDP, and bank loans were 42%, compared with 22% of GDP for equities. The rise in share prices and increase in new stock issues raised the ratio of stock market capitalization to 80% of GDP in 1993–95. With the improvement in the financial markets, the other instruments also rose in importance—bonds to 41% and bank loans to 52% of GDP. Foreign capital inflows fueled much of the increase in equity investment as combined foreign equity and portfolio investment increased.

The Philippine domestic bond market remains underdeveloped compared with the bank lending and equity sectors. It consists of short- and long-term bonds, mainly issued by the national government. At present, government issues dominate the market with minimal alternatives for other types of debt instruments. Although the size of the Philippine corporate bond market is small, it is growing rapidly over the years.
X. Next Step → Future Direction

A. Future Direction

B. G-30 Compliance

<table>
<thead>
<tr>
<th>Recommendation</th>
<th>Implemented</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Eliminate paper and automate communication, data capture, and enrichment.</td>
<td>No</td>
</tr>
<tr>
<td>2. Eliminate paper and automate communication, data capture, and enrichment.</td>
<td>Not all bonds are dematerialised or immobilised</td>
</tr>
<tr>
<td>3. Harmonize messaging standards and communication protocols.</td>
<td>No</td>
</tr>
<tr>
<td>4. Harmonize messaging standards and communication protocols.</td>
<td>The local CSD and most local market participants do not use SWIFT.</td>
</tr>
<tr>
<td>5. Develop and implement reference data standards.</td>
<td>No</td>
</tr>
<tr>
<td>6. Develop and implement reference data standards.</td>
<td>There is no securities numbering agency for bonds. The Bureau of the Treasury issues its own ISIN-like numbering for government securities while PDEx assigns series name following the same convention for listed corporate securities.</td>
</tr>
<tr>
<td>7. Synchronize timing between different clearing and settlement systems and associated payment and foreign exchange systems.</td>
<td>Yes</td>
</tr>
<tr>
<td>8. Synchronize timing between different clearing and settlement systems and associated payment and foreign exchange systems.</td>
<td></td>
</tr>
<tr>
<td>9. Automate and standardize institutional trade matching.</td>
<td>Yes</td>
</tr>
<tr>
<td>10. Automate and standardize institutional trade matching.</td>
<td>For government and listed corporate bonds</td>
</tr>
<tr>
<td>11. Expand the use of central counterparties.</td>
<td>No</td>
</tr>
<tr>
<td>12. Expand the use of central counterparties.</td>
<td></td>
</tr>
<tr>
<td>13. Ensure the financial integrity of providers of clearing and settlement services.</td>
<td>Yes</td>
</tr>
<tr>
<td>14. Ensure the financial integrity of providers of clearing and settlement services.</td>
<td></td>
</tr>
<tr>
<td>15. Reinforce the risk management practices of users of clearing and settlement service providers.</td>
<td>Yes</td>
</tr>
<tr>
<td>16. Reinforce the risk management practices of users of clearing and settlement service providers.</td>
<td></td>
</tr>
<tr>
<td>17. Ensure final, simultaneous transfer and availability of assets.</td>
<td>Yes</td>
</tr>
<tr>
<td>18. Ensure final, simultaneous transfer and availability of assets.</td>
<td>Existing central bank regulations on investments in fixed income securities by foreign investors only allow the foreign investors to contract a FX deal to sell PHP and buy foreign currency upon actual receipt of the license to be issued by the central bank.</td>
</tr>
<tr>
<td>19. Ensure effective business continuity and disaster recovery planning.</td>
<td>No</td>
</tr>
<tr>
<td>20. Address the possibility of failure of a systematically important institution.</td>
<td>No</td>
</tr>
<tr>
<td>21. Strengthen assessment of the enforceability of contracts.</td>
<td>Yes</td>
</tr>
<tr>
<td>22. Strengthen assessment of the enforceability of contracts.</td>
<td></td>
</tr>
<tr>
<td>23. Advance legal certainty over rights to securities, cash, or collateral.</td>
<td>Yes</td>
</tr>
<tr>
<td>24. Recognize and support improved valuation methodologies and closeout netting arrangements.</td>
<td>Yes</td>
</tr>
<tr>
<td>25. Ensure appointment of appropriately experienced and senior board members (of the boards of securities clearing and settlement infrastructure providers).</td>
<td>Yes</td>
</tr>
<tr>
<td>26. Promote fair access to securities clearing and settlement networks.</td>
<td>Yes</td>
</tr>
<tr>
<td>Potential barrier area</td>
<td>Current situation</td>
</tr>
<tr>
<td>------------------------</td>
<td>-------------------</td>
</tr>
<tr>
<td>Quotas</td>
<td>No restrictions are placed on foreigners investing in Philippine securities.</td>
</tr>
<tr>
<td>Investor registration</td>
<td>Foreign investments need not be registered with the BSP unless the FCY needed to service the repatriation of capital and the remittance of dividends, profits and earnings is purchased from the banking sector. These restrictions are therefore covered under repatriation of funds.</td>
</tr>
<tr>
<td>FX controls - conversion</td>
<td>FX requires evidence of an underlying securities transaction, if the funds are to be eligible for subsequent repatriation. Third-party foreign exchange trades are permitted. The third-party bank must send the Certificate of inward Remittance (CIR) to the sub-custodian bank at the same time it transfers the PHP, otherwise it is not possible to raise a BSRD, thereby preventing subsequent repatriation. Offshore FX (PHP/USD) is allowed provided PHP cover is done onshore. Circular 645 (issued February 2009) allows local custodians to issue the BSRD for inward foreign investments in government securities on behalf of BSP. We note that there is an ongoing dialogue between BSP and the custodian banks to streamline the reporting requirements.</td>
</tr>
<tr>
<td>FX controls - repatriation of funds</td>
<td>There are no restrictions on the amount of currency that can be remitted or repatriated subject to submission to BSP of required documentation. However, the repatriation of funds must be accompanied by a BSRD together with the required supporting documents. The regulations only allow the foreign investors to sell PHP and buy FCY upon actual receipt of the license to be issued by the BSP - there is no standard processing period which may range from one week to two weeks for government securities and longer for corporate bonds. The BSP may also require additional documentation, giving the impression that the process is somewhat arbitrary. Purchases of PHP intended for securities investments that are ultimately cancelled cannot be repatriated unless the PHP is first re-invested. Overall, a considerable burden is placed on the custodian bank. It is at the time of repatriation, rather than the original inward investment, that problems are most likely to occur.</td>
</tr>
<tr>
<td>Cash controls - credit balances</td>
<td>Cash credit balances are permitted. BSRD-eligible transactions include investments in listed securities, government debt, and time deposits</td>
</tr>
<tr>
<td>Potential barrier area</td>
<td>Current situation</td>
</tr>
<tr>
<td>-------------------------------------------</td>
<td>-------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------</td>
</tr>
<tr>
<td>or other money market instruments with maturities of 90 days or greater. Foreign investors can open interest-earning accounts.</td>
<td></td>
</tr>
<tr>
<td>Cash controls - overdrafts</td>
<td>PHP overdrafts to non-residents are not permitted. This means that foreign investors must ensure that cash accounts are adequately funded (cleared funds) prior to settlement date. Foreign broker-dealer clients which do intraday trading are especially affected by this restriction, and difficulties arise if the sale side fails. Market authorities have pointed out that with the recent regulation allowing non-residents to do FX swaps, the above concern has been addressed.</td>
</tr>
<tr>
<td>Taxes</td>
<td>Both resident and non-resident investors are subject to withholding tax of 20% on the interest from government bonds, and 30% on the interest from corporate bonds (recently reduced from 35%). These rates are high by international standards. For non-residents, the withholding tax rate may be reduced under a double taxation agreement. Eligible investors must submit all necessary documentation to the Bureau of Internal Revenue (BIR). The documentation is fairly onerous. Investors have also commented that the requirements are not clear. For government securities, investors must also confirm to the Bureau of Treasury that it is a ‘buy-to-hold’ portfolio. Tax reclams are available via direct filing with the BIR, but take years and are rarely successful. A number of market participants mentioned Philippines as a problem in this area.</td>
</tr>
<tr>
<td>Omnibus accounts</td>
<td>Foreign investors are permitted to use omnibus accounts.</td>
</tr>
<tr>
<td>Settlement cycle</td>
<td>The settlement cycle for local bond trades is T+0. However, for cross-border bond trades it is T+2 (or by agreement).</td>
</tr>
<tr>
<td>Message formats</td>
<td>The local CSD and most local market participants do not use SWIFT. A number of market participants mentioned Philippines as a problem in this area.</td>
</tr>
<tr>
<td>Securities numbering</td>
<td>ISIN codes are available for all local bonds, and are available for new issues at issue date. Most local market participants use ISIN. However, the local CSD uses local securities codes.</td>
</tr>
<tr>
<td>Matching</td>
<td>There is a trade matching system for government securities and some listed corporate bonds. There is a pre-settlement matching system for government securities among Government Securities Eligible Dealers (GSEDS).</td>
</tr>
<tr>
<td>Dematerialisation</td>
<td>Not all bonds are dematerialised or immobilised.</td>
</tr>
<tr>
<td>Regulatory framework</td>
<td>Investors commented that rules and regulations are clear. However, there can be abrupt regulatory changes which create regulatory risk.</td>
</tr>
</tbody>
</table>
References:

- Asianbondsonline website (www.asianbondsonline.adb.org)
- Securities and Exchange Commission (www.sec.gov.ph)
- Bangko Sentral ng Pilipinas (www.bsp.gov.ph)
- Bureau of the Treasury (www.treasury.gov.ph)
- PDEx (www.pdex.com.ph)
- Money Market Association (www.mart.com.ph)
ABMF SF-1

Korea Bond Market Guide

Version: No.3_21/June/2011
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   B. Descriptions for the Public Offering and Private Placement Market
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   D. Professional (wholesale) market / Retail Market
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   F. Definition of Professionals / Professional Investors
   G. Methods of Issuing Bonds
   H. Credit Rating Agencies and the Credit Rating of Bonds
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I. High Level Structure, Type & Characteristics of the Bond Market

A. Classification & Descriptions for the Bond Market in Korea

1. Classification of Bonds

   Publicly offered bonds are classified by type of issuer into the following.
   - Government bond,
   - Municipal bond,
   - Special bonds including Monetary stabilization (MSB), Bank, and other Financial Bonds,
   - Corporate bonds, and
   - Asset-backed securities (ABS).

2. Descriptions for each bond

   a. Government bonds

      The first government bonds in Korea were the nation-building government bonds in 1949. Since then, a wide variety of government bonds have been issued and have been integrated into Korea Treasury bonds (KTB) since the Bonds on Fund for Management of Government Bonds were issued in 1994.

      Currently, the government bonds issued include KTB, National Housing Bond (NHB) Type 1 and 2, and Foreign Exchange Equalization Fund Bonds (FEEFB), which are denominated in foreign currency. Among them, KTB are issued in the largest volume and trading is active. Accordingly, the on-the-run KTB market yields serve as a benchmark yield.

      There are currently four types of KTB issued by maturity; three-year, five-year, and 20-year, and depending on the rate of interest, they fall into fixed interest type bonds (three-year, five-year, ten-year, and 20-year) and inflation-linked KTB (ten-year maturity).

      Inflation-linked KTB link the principal and coupon rate of the KTB to prices, thereby eliminating risk from inflation that come with investing in KTB, thus ensuring the purchasing power parity of the bonds.

   b. Municipal bonds

      Municipal bonds are issued by local government, which comprise industrial development bonds and subway construction bonds.

   c. Special bonds

      Special bonds consist of monetary stabilization bond issued by Bank of Korea, Bank bonds issued by commercial banks, and other financial bonds issued by financial institutions excluding commercial banks.

   d. Corporate bonds

      Corporate bonds issuances are divided into direct issuances and indirect issuances depending on who issues the bonds. Indirect issuance comprises of firm commitment, stand by agreements and a best effort basis depending on who handles the risk
related to the underwriting. In addition, bonds comprise of par value, discount issue, and issues at a premium. The types of corporate bonds can be categorized into bonds with guarantees or collateral, ways of paying interest, and the rights given to holders of corporate bonds.

Bonds with guarantees or collateral fall into guaranteed bonds, collateral bonds, and non-guaranteed bonds. Guaranteed bonds refer to corporate bonds where a financial institution guarantees the redemption of the principal and interest.

Guarantees of the principal and interest payments are provided by banks, Korea Credit Guarantee Fund, Korea Technology Finance Corporation, merchant banks, financial investment companies and surety insurance companies.

The issuing company pays a guarantee fee to the guaranteeing company. Collateral bonds are secured by physically guarantee redemption of the principal and payment of interest. They are issued in accordance with the Secured Bond Trust Act. Non-guaranteed bonds are issued by the issuer’s credit without the guarantee or collateral provided by a financial institution for principal redemption.

Most Korean corporate bonds are issued as debentures. The underwriters of the bonds are required to undergo credit assessment of the debentures from two or more different credit rating agencies.

Bonds categorized by their interest payment as coupon bonds, discount bonds, and compound bonds. Coupon bonds refer to corporate bonds with coupons denoting the payment of interest at a regular schedule. Discount bonds are corporate bonds where the principal and interest rate are the par value and the interest is discounted in the lump sum. Compound bonds involve the computing of compound interest for the interest cycle. Thereafter, the principal and interest are paid in a lump sum on the date of maturity.

Depending on the redemption periods, bonds can be divided into short-term bonds, mid-term bonds, and long-term bonds. Generally, short-term bonds have redemption periods under one year, mid-term bonds have redemption periods between one year and five years; long-term bonds have redemption periods over five years. Of note, long-term bonds refer to bonds that mature in 10 or 20 years in the U.S.

In addition, there are fixed-income bonds and floating rate notes (FRN) depending on how interest is paid. Fixed-income bonds involve the payment of a fixed periodic returns, FRN has a variable interest rate that is linked to the benchmark interest rate.

Bonds categorized by the holder of the bonds are convertible bonds, bonds with warrant, exchangeable bonds, participating bonds and bonds with embedded option. Convertible bonds (CB) can be converted to the issuing company’s equity on certain conditions. Bonds with warrants entitle the holder to purchase a certain quantity of any future issue of the company’s stocks at a fixed price after a set period of time has passed. Exchangeable bonds permit the holder to exchange his/her bond holding for the listed shares of a company under previously agreed conditions within a set timeframe. Participating bonds entitle the holder to receive dividends.

Bonds with embedded options allow the issuer to redeem all or part of the bond before it reaches its maturity date. The options include call options where the issuer can redeem the principal and interest before maturity and put options, which allows the holder of the bond the right to demand the issuer repay the principal on the bond.
e. Asset-Backed Securities (ABS)

An asset-backed security (ABS) is a security that is issued based on underlying assets originating from corporations or financial institutions.

By standardizing and pooling the financial assets from originators in specific terms, such assets are securitized utilizing the cash flows of underlying assets and credit enhancement. The ABS then channels the principal and interest to the concerned parties.

An ABS is bankruptcy remote from the originator, which means the credit risks of ABS are segregated from the credit risks of the originators, and thus an ABS is issued with the credit ratings of the underlying assets. In addition, the credit ratings of an ABS are determined by assessing the credit risk of the underlying assets and credit enhancement. Through credit enhancement and structuring, an ABS is highly likely to receive a higher credit rating than that of the originators.

An ABS provides a wide range of benefits for originators, investors, and other market participants. From the perspective of originators, ABS are advantageous in that they allow corporations or financial institutions to issue securities with higher credit ratings and thereby raise capital at relatively lower costs, since an ABS usually receive a higher credit rating than the originators by assessing the structural features, cash flows and credit enhancement of underlying assets.

In addition, ABSs are another effective tool to finance funds for originators as they can be utilized as off-balance sheet assets. Financial institutions issue ABSs to enforce the management of equity capital. Moreover, through asset-backed securitization, asset portfolios can be diversified or the risk thereof can be dispersed among different social classes and regions of debtors.

From the investor's perspective, on the other hand, asset-backed securities are attractive products that fit various investment preferences in terms of risk and maturity. Moreover, an asset-backed security is likely to yield relatively higher profits than other bonds with the same credit ratings thanks to the liquidity premium as well as its structural premium.

Asset-backed securities contribute to the development of the overall financial market in that they encourage securities firms to analyze various assets and build knowledge of new types of securities, thereby providing the new sources of profits for a wide range of interested parties.

[2010, Capital Market in Korea, p.119~120, p.122~124, p.171~172]

B. Descriptions for the Public Offering and Private Placement Market

1. Public Offering

Public offerings generally refer to actions with the aim of selling to multiple ordinary investors. The Financial Investment Service and Capital Market Act (FSCMA) define a public offering as an offering and sale.

The term “public sale” in the Act refers to gathering 50 or more investors, as calculated by a formula prescribed by Presidential Decree, to make an offer to sell or invite offers.
to purchase securities already issued (FSCMA Article 9.(9)). In other words this means soliciting 50 or more investors (the sum of those who have received recommendations) that have not made, applied to, or bought the same type of securities as the relevant securities being offered within six months of the day offers to buy are made.

As such, the FSCMA refers to recommendations for application for public offering and sale to the public during the previous six months.

Here, the “public” refers to the parties that are subject to the offers and sale and consisting of 50 or more investors.

2. Private Placement

Private placement refers to a private offering of securities for new issuance to investors. Therefore, private placement entails that the issuer issues securities directly to certain demand-side parties to raise capital from them.

This means that the bond certificate is only issued to the subscriber or has third party underwriting. It is referred to as private placement since it is not intended for the public.

[2010, Capital market in Korea, p.117~118]

C. Exchange Listed Market

The Korean bond exchange market comprise of the Inter Dealer Market (IDM) and the retail market. Among these markets, the primary dealers mainly participate in the IDM. Before the Asian financial crisis in the late 1990’s, the Korean bond market comprised mostly corporate bonds.

In 1998, during the financial crisis, the IMF bailout prompted the Korean government to announce the “Measure to Improve Government Bond Policies and Vitalize the Bond Market”. As part of the process to facilitate development of the government bond market, PDs were introduced in 1999, and the IDM was opened in the KRX.

Participants in the IDM are limited to financial investment firms and banks. The bid and ask order details presented by each dealer are collected and disclosed on the system, and transactions are made among dealers. The tick size is KRW1 and uses the limit order method. The order quantity is a whole number multiple of KRW1bn.

The market opens from 9 am to 3 pm and transactions are made through individual competitive bidding using multiple prices depending on the priority of best quotation and time principle from the presented bid ask price. Settlement generally takes place through BOK-Wire and the bonds are transferred through escrow accounts at the KSD.

It is thus similar and year slightly different from the OTC market the delivery versus payment (DVP). In other words, the OTC DVP method settles the total amount for each transaction, while in the exchange market, the funds are settled depending on the participant, and bonds are subtracted depending on the participant and [bond] issues. The settlement data is T+1.
In the ordinary bond market, transactions generally involve retail bonds, small-cap government and public bonds, and equity linked corporate bonds, with ordinary investors being the main participants. Retail and small cap bonds are traded in units of KRW 1,000, while equity-related corporate bonds and ordinary bonds are traded in units of KRW 100,000. Transactions are concluded through individual competitive bidding, and are concluded through four types of competitive bidding principles, depending on the priority of price, time, brokerage and quantity.

[2010, Capital Market in Korea, p.130–131]

D. Professional (wholesale) market / Retail Market

1. Professional (wholesale) market

Under discussion on QIB market

E. Mutual relations of above markets type / category

The primary market is restricted to participants if the investors are not professional such as PDs. So, a related market with above in section 1.04 is secondary market, and the secondary market includes the following:

1. Repo Market

Repo refers to the sale (or purchase) of bonds with a commitment to repurchase (or resell) them at a specific future date. Repo transactions in Korea comprise retail repo (transaction between retail investors and financial institutions) and inter-institution repo. Inter-institution repos can be traded over-the-counter.

In order to facilitate repo transactions among institutional investors, the KRX established a repo market based in February 2002 on an electronic trading platform.

The size of the domestic repo market is about KRW62.4 trillion as of the end of April 2009 with the retail repo taking up 98% of total transactions.

The main reason why the inter-institution repo market is not very active is the wide use of the call market—the interbank loan market in Korea. Unlike the US and other countries where only qualified institutions such as commercial banks are allowed to participate in the federal funds market, a wide variety of institutions—commercial banks, brokerage firms, insurance companies, and some government enterprises—are allowed to participate in the call market in Korea.

As a result, the institutions that have access to the call market do not need to find it necessary to use the repo market.

2. KTB Futures Market

The KTB futures market was launched in the KRX in 1999 to provide investors with the tools of risk management against the volatility of market interest rates.

Currently, three kinds of KTB futures—3-year, 5-year, and 10-year—and MSB interest rate futures are listed on the KRX.
Only those financial companies that have obtained a license to engage in the financial investment business for exchange-traded derivatives in accordance with the Capital Market Act can participate in the KTB futures market.

Other financial institutions, nonfinancial firms, and individuals can participate in the KTB futures market by consigning their trading to member firms.

The member firms serve their clients in a fiduciary capacity by placing orders for the customers. Investors in KTB futures are subject to various margin requirements including the prior margin, net risk margin, and the maintenance margin.

Margins can be paid with the Korean won, substitute securities, or foreign currencies.

<Table> shows trends in the trading activities of KTB futures in terms of the annual trading value. The trading of 3-year KTB futures dominates trading in the KTB futures market as the 3-year KTB plays the role of the benchmark issue in the KTB cash market.

<table>
<thead>
<tr>
<th>Year</th>
<th>3 Year-KTB (KRW billion)</th>
<th>5 Year-KTB</th>
<th>10 Year-KTB</th>
<th>Total (KRW billion)</th>
</tr>
</thead>
<tbody>
<tr>
<td>2001</td>
<td>981,176</td>
<td>-</td>
<td>-</td>
<td>981,176</td>
</tr>
<tr>
<td>2002</td>
<td>1,342,955</td>
<td>-</td>
<td>-</td>
<td>1,342,955</td>
</tr>
<tr>
<td>2003</td>
<td>1,124,052</td>
<td>19,497</td>
<td>-</td>
<td>1,143,550</td>
</tr>
<tr>
<td>2004</td>
<td>813,023</td>
<td>7</td>
<td>-</td>
<td>813,030</td>
</tr>
<tr>
<td>2005</td>
<td>1,234,152</td>
<td>66</td>
<td>-</td>
<td>1,234,218</td>
</tr>
<tr>
<td>2006</td>
<td>1,122,370</td>
<td>375</td>
<td>-</td>
<td>1,122,745</td>
</tr>
<tr>
<td>2007</td>
<td>1,455,094</td>
<td>11</td>
<td>-</td>
<td>1,455,105</td>
</tr>
<tr>
<td>2008</td>
<td>1,702,638</td>
<td>-</td>
<td>454</td>
<td>1,703,092</td>
</tr>
<tr>
<td>2009</td>
<td>1,655,906</td>
<td>-</td>
<td>-</td>
<td>1,655,906</td>
</tr>
</tbody>
</table>

Note: KTB = Korean Treasury bonds. Year 2009 value covers from January to September.
Source: Korea Exchange homepage

[Bond Market in Japan and Korea]

F. Definition of Professionals / Professional Investor

1. Definition of Professionals/ Professional Investors

The Financial Investment Service and Capital Market Act (FSCMA) classifies an ordinary investor and a professional investor based on the expertise of their professional knowledge and experience as well as the amount of assets.

A professional investor refers to an investor who does not need any strong investor protection measures considering its own expertise and experience, such as a nation, a local municipality, a central bank, and a financial institution.

Most individual investors fall under the classification of an ordinary investor with the exception of an investor whose financial investments exceeds 5 billion won.
Such classification aims to protect ordinary investors from taking huge risks in making investment due to the lack of such understanding of the financial investment instruments.

[2010, Capital market in Korea, p.297]

G. Methods of Issuing Bonds

1. Methods of issuing Government Bonds

Issuing Procedures for KTB

① Establish Plans to Issue KTB
   - The Ministry of Strategy and Finance must discuss with relevant agencies any plans to issue KTB and the issue is subject to deliberation by the National Assembly.
   - Establish a detailed issuing plan within the annual KTB issuance limit approved by the legislature
   - Announcement of Issuing Plans and Bidding
   - The Minister of Strategy and Finance announces annual/monthly plans for each year
   - In principle the date/time of bidding issuing amount, coupon rate and settlement, re-disclosed up to three days prior to the commencement of bidding.

② Bidding
   - Bidding Date
     - 3-yr KTB: Every first Monday
     - 5-yr KTB: Every second Monday
     - 10-yr KTB: Every third Monday (Wednesday for inflation-linked KTB)
     - 20-yr KTB: Every fourth Monday
   - Bidding time: 10:40 am ~ 11:00 am
   - Bidding type and method of selecting successful bid
     - Bidding is electronic using BOK-Wire (a network operated by the Bank of Korea)
     - The bid interest rate are grouped in intervals of 3bp from the highest successful bid downwards within the range of amount to be issued, and the highest successful bid's interest rate in each group is applied
   - Participants in the bidding
     - Only KTB primary dealers are eligible to participate in KTB auctions.
     - Non-primary dealer bidders may bid through KTB primary dealers who act as proxy agents.
     - However, if a retail investor bids through a primary dealer the bid security deposit and written bid should be submitted in advance.

③ Announcement of Bidding and Results
   - The Minister of Strategy and Finance announces the details of bidding and the accepted bids when they are complete.

④ Issuance of KTB and Settlement of Successful Bids
   - Issuance of KTB and payment of the successful amount are done after the bidding date.
On the day of settlement, the Korea Securities Depository (KSD) is notified by BOK-Wire immediately after the underwritten amount is remitted and the settlement and issuance are completed.

- All KTB types are registered and issued and deposited at the KSD. Accordingly, transaction and exercise of rights are possible without issuance of physical bond certificates.

[2010, Capital Market in Korea, p.125]

2. Methods of issuing Corporate Bonds

Issuing Procedures for Corporate Bonds

① Company Registration
- Register with Financial Services Commission (FSC) for public issue of non-guaranteed bonds

② Issue Credit Rating
- Submit for credit assessment, evaluation (requires two to four weeks)
- Credit rating from two or more credit rating agencies is required.

③ Decision by BOD
- Issues related to issuing corporate bonds are decided upon resolution by the BOD (determine issuing amount, issuing interest rate, managing company, and etc).

④ Sign to Pay Principal and Interest as Agent
- Decide where to pay corporate bond and which institution will pay principal and interest after the corporate bond is issued as its agent indicate on application form and bond certificate

⑤ Select Manager and Trustee
- Select managing company that will underwrite and manage corporate bonds and a trustee that will take the necessary measures to protect the bond holders from the period of time involving payment for bonds to principal repayment

⑥ Due Diligence
- Lead manager, etc, checks for risk factors through due diligence of companies

⑦ Submit Securities Report
- Submit securities report and attached documents (subscription agreement, trustee agreement, principal and interest payment agency agreement, etc) to Korea Financial Investment Association (KOFIA).

⑧ Take Effect
- Unsecured corporate bonds: Seven days after registration statement submission
- Secured bonds, collateral bonds, ABS: Five days after registration statement submission
- Shelf registration: Five days after registration statement submission

⑨ Submit Prospectus
When the bond takes effect after the submission of the registration statement, the issuer distributes and discloses the prospectus at its branches, KOFIA, and firms that will accept applications.

Issuance and Payment
- Issuance, payment and listing take place simultaneously.

Issuance Reporting
- After issuance is complete, issuance report is submitted to the FSS.

Report Underwriting by Managers
- Report underwriting performance by managing companies to KOFIA five days from issuance day.

[2010, Capital Market in Korea, p.125]

H. Credit-Rating Agencies and the Credit Rating of Bonds

1. Private Credit Rating Agencies for Bond Established

There are four companies, Korea Ratings, KIS Pricing, NICE Pricing Services, and SCI Pricing for Credit-Rating.

<table>
<thead>
<tr>
<th>Korean Credit Rating Agencies</th>
<th>Korea Ratings</th>
<th>KIS</th>
<th>NICE</th>
<th>SCI</th>
</tr>
</thead>
<tbody>
<tr>
<td>Capital</td>
<td>KRW34.05bn</td>
<td>KRW5bn</td>
<td>KRW5bn</td>
<td>KRW17.75bn</td>
</tr>
<tr>
<td>No. of employees</td>
<td>170</td>
<td>109</td>
<td>121</td>
<td>217</td>
</tr>
<tr>
<td>M/S(%)</td>
<td>34.3</td>
<td>33.4</td>
<td>31.6</td>
<td>0.6</td>
</tr>
<tr>
<td>Largest shareholder</td>
<td>Fitch (73.55%)</td>
<td>Moody's (50%+1 share), KIS (50%-1)</td>
<td>NICE (100%)</td>
<td>SP Partners (19.19%)</td>
</tr>
<tr>
<td>Bonds for evaluation</td>
<td>Corporate bonds, CP, ABS</td>
<td>Corporate bonds, CP, ABS</td>
<td>Corporate bonds, CP, ABS</td>
<td>CP, ABS</td>
</tr>
<tr>
<td>Partner companies in credit assessment</td>
<td>Fitch</td>
<td>Moody's</td>
<td>Japan R&amp;I, China Dagong Rating</td>
<td>Japan JCR</td>
</tr>
</tbody>
</table>

* As of June 2009
** Market share source: Financial Supervisory Service press release (Credit Information Service Providers’ Operating Results: 2008)

2. Credit-Rating Assessment

a. Corporate Bond Assessment

When a company issues corporate bonds in order to raise long term capital for over one year from the direct financing market, they are required to obtain a credit rating from a specialized credit rating agency for all non-guaranteed bonds in order to protect
small-cap investors who lack professional knowledge on the issuer, and in order to induce a reasonable price in the bond market.

All non-guaranteed corporate bonds, excluding government bonds and bonds, for which the government has guaranteed the payment of principal and interest, as well as municipal bonds, and monetary stabilization bonds issued by BOK, must receive a credit rating in order to be included in the trusted assets of banks and investment trust companies.

In other words, bonds being issued without guarantee including those by ordinary companies, specialized lenders, financial investment firms, commercial banks, the Korea Development Bank, government funded agencies and pension funds, must first receive a credit assessment from a specialized credit rating agency. Corporate bonds’ credit ratings are used as criteria for deciding upon investment when issuing and trading non-guaranteed bonds.

It is also used as criteria for the mark to market value of funds that are subject to mark to market.

Bonds are rated in 10 grades depending on how much of the principal and interest is payable, from AAA to D. AAA to BBB are investment grade where the principal and interest are deemed to be recoverable, while BB to C are classified as speculative grade as they are heavily by change in the investment environment.

<table>
<thead>
<tr>
<th>Grade</th>
<th>Definition</th>
</tr>
</thead>
<tbody>
<tr>
<td>AAA</td>
<td>Highest ability to repay principal and interest</td>
</tr>
<tr>
<td>AA</td>
<td>Excellent ability to repay principal and interest but slightly less than AAA rated bonds</td>
</tr>
<tr>
<td>A</td>
<td>Very good ability to repay principal and interest but vulnerable to economic conditions and environment</td>
</tr>
<tr>
<td>BBB</td>
<td>Good ability to repay principal and interest but possibility exists of economic conditions and environment deterioration lowering its ability to repay principal and interest going forward</td>
</tr>
<tr>
<td>BB</td>
<td>Although its ability to repay principal and interest is not immediately problematic, the bonds have speculative factors since stability going forward is not guaranteed</td>
</tr>
<tr>
<td>B</td>
<td>Ability to repay principal and interest are lacking; is speculative; in recession repayment of interest is not certain</td>
</tr>
<tr>
<td>CCC</td>
<td>Uncertainties currently exit in its ability to repay principal and interest. Highly speculative given the high risk of default.</td>
</tr>
<tr>
<td>CC</td>
<td>Higher uncertainty factors exit compared with the upper grades.</td>
</tr>
<tr>
<td>C</td>
<td>High risk of default; lacks ability to repay principal and interest</td>
</tr>
<tr>
<td>D</td>
<td>Unable to repay</td>
</tr>
</tbody>
</table>

*Among the above grades, AA to B are marked with the signs + or – to denote the superior or inferior recoverability of principal and interest*

Source: Korea Investors Service (KIS)

b. Commercial Note Assessment

The decision to invest and issuance conditions are determined by the credit rating of the issuers of commercial paper, which is issued to raise short-term operating funds.

Accordingly, the government has objective credit rating agencies rate the credit of the issuing companies and disclose the results in order to develop the commercial note market into a market where blue chip companies may raise short-term capital.

This assessment is used to protect the investors and enable financial institutions to serve as brokerages, and ensure financial soundness of management.
Companies that seek to obtain short-term financing by issuing unsecured debentures or notes issued to borrow and lend money among customers with merchant banks, brokerage houses and banks acting as intermediaries are required to undergo credit assessments for their commercial paper.

Credit rating grades for commercial paper are used to determine the soundness of the commercial paper (unsecured commercial paper and the merchant bank intermediary notes) issuance and are used as criteria for deciding terms and conditions of issuance.

Credit ratings for commercial paper comprise six grades from A1 to D. Among the grades, A1 to A3 are investment grade where the issuers of whom have been acknowledged to have the ability to repay principal and interest in a timely manner; B and C are speculative grades where the repayment of principal and interest on time is heavily influenced by changes in the environment.

<table>
<thead>
<tr>
<th>Grade</th>
<th>Definition</th>
</tr>
</thead>
<tbody>
<tr>
<td>A1</td>
<td>Best ability to repay on time and best stability of repayment ability</td>
</tr>
<tr>
<td>A2</td>
<td>Very good ability to repay on time but stability slightly inferior to A1</td>
</tr>
<tr>
<td>A3</td>
<td>Good ability to repay on time with good stability but inferior to A2</td>
</tr>
<tr>
<td>B</td>
<td>Adequate ability to repay on time but speculative issues exist in its stability depending on short-term changes in conditions</td>
</tr>
<tr>
<td>C</td>
<td>Highly speculative issues in ability to repay on time and in its stability</td>
</tr>
<tr>
<td>D</td>
<td>Cannot repay</td>
</tr>
</tbody>
</table>

* Among the above grades, A2 to B grades are marked with + or _ to denote the superior or inferior ability to repay principal and interest.

Source: Korea Investors Service
c. Asset-backed Securities Assessment

Asset-backed securities (ABS) are given credit rating grades the same way as non-guaranteed corporate bonds or commercial paper, depending on the type (ABS and ABCP). The credit rating system and definitions are made the same as the system and definition of non-guaranteed corporate bonds and commercial paper, thereby easing decisions on the issuer’s ability to repay principal and interest on the ABS.

[2010, Capital Market in Korea, p149~150]

I. Bond Related Systems for Investor Protections

1. Overview

The Korea Financial Investment Association (KOFIA) places the highest of priorities on protecting investors.

As a self-regulatory organization, the KOFIA promotes discipline and fair practices in the securities markets.

It also recommends policies to the government to improve regulations and laws to better protect all market participants, especially investors.

KOFIA also contributes to the protection of bond investors through the standard debenture entrustment contract, which sets forth the roles and responsibilities of the trustees and monitors whether they are maintaining their ability to repay the principal and interest on their loans.

When an event of default occurs to the issuer, which is one of the major details of an entrustment contract based on relevant provisions in the contract, the trustee announces this information to the trust and BIS, which enables notification to all the investors.

In Korea, the Securities and Exchange Act forms the basis of investor protection policy. The Act, along with other related laws, places emphasis on three areas: timely and proper disclosure, prohibition of insider trading, and improvement of audit system.

2. Disclosure in the Secondary Market

a. Disclosure of OTC trade execution details

After a brokerage house sells a bond in the OTC market, it must report to KOFIA the details of the transaction within 15 minutes, categorized by the nature of transaction. KOFIA then discloses this information. The disclosure mandate was introduced in 2000 to enhance market transparency and increasing credibility in trade price.

Behind the introduction of the 15-minute rule were aspirations towards enhancing market transparency and encouraging more bond derivatives into the market. Previously, the details of a transaction were reported to KOFIA after 15:00 when the market was closed. Under such system, transaction details could not serve as market information in a timely manner, undermining discovery function of the appropriate price, which hindered the development of bond derivatives.
In 2000, when the disclosure of trade execution details was introduced, the details of the transaction had to be reported within 30 minutes.

This was reduced the following year to within 5 minutes, and then settled to within 15 minutes in 2002. In order to increase the accuracy of reporting details of OTC bond transactions, KOFIA has created the Bond-Trade Report & Information Service (B-TriS), which enables real-time management of data between KOFIA and financial investment companies.

As of June 2010, an average of 3,724 trade executions were reported daily. The 15 minute rule not only enhanced market transparency, but reduced the cost of searching for price information.

Furthermore, it increased the pace of the information distributed through the real-time provision of issues, trading volume, yields, and investor categorization codes, and encouraged more investors to trade bonds.

b. Disclosure of OTC quotation information

Besides the 15-minute rule, which promotes post-trade transparency, it was also necessary to introduce a service for enhancing pre-trade transparency so that market transparency in general and liquidity could be enhanced. Therefore, KOFIA introduced the Bond Quotation System (BQS) in 2007.

At the time of the introduction, most OTC bond trades were made using private messenger services, such as Yahoo and MSN, as a negotiating method. Compared to telephone negotiation, private messenger contributed, in part, to a reduction in bid/ask spreads and increases liquidity.

However, it also comprised of multiple messenger groups, and thus dispersed liquidity and made it difficult to access market quotation information in real-time. In fact, private messenger served as an entry barrier for new participants such as retail investors and foreigners.

Therefore, the government announced the introduction of the disclosure of OTC quotation information in line with the Reformation of Bond Trading Market (December 12, 2006).

KOFIA requires financial investment firms (including banks and merchant banks) as well as IDBs to report, in real-time, all the information on quotes and exercise price of all bonds traded in the OTC market through the Bond Quotation System (BQS).

Through this system, all OTC quotes are collected and disclosed, enhancing the function of price discovery and increasing transparency and liquidity in the OTC market.

c. Disclosure of final quotation yields, etc.

When the market closes, KOFIA posts the yield of each bond that represents the Korean bond market on its Bond Information Service. Thus, they can be used as major indices for economic policies, financial institutions asset management, and the appraisal of investment performance (tallied at 11:30 and 15:30 each working day/disclosed at 12:00 and 15:30 each working day).
The final quotation yield disclosed by KOFIA comprises of final quotation yields for particular yields to maturity (8 types, 15 yields) and final quotation yields by yield to maturity (5 types, 47 yields).

In addition, to help energize the OTC bond market, KOFIA discloses base yields that are used for daily closings and derives the final settlement price for government bonds (3-yr, 5-yr) and MSB (364 days), and market-making quotation yields for bond-specialized dealers. KOFIA also discloses CP issuance information management, yields and indices, CD yields and transaction status, customer RP transaction status, and intermediary transactions of RP among institutions. Moreover, since December 1999, KOFIA has announced on a daily basis the ‘KOFIA-Bloomberg Bond Index’, an indicator of changes in the bond value of certain groups over time.

From February 27, 2009, KOFIA has disclosed default rates and recovery rates to enhance the price discovery function of the high-yield bond market, and promote the development of new bond-related products, and to use as raw data for risk management.

In addition, from June 2009, KOFIA has provided real-time bond indices, enabling real-time assessment of the bond market and the development of new index-linked bond products, including ETFs. Related to this, the first Korean KTB ETF was listed on KRX on July 29, 2009.

3. Introduction of the Electronic Disclosure System

KOFIA has played in key role in improving transparency of OTC bond trading and valuation. Starting in July 2002, all securities companies have been required to report trading details to KOFIA within 15 minutes after trading execution.

KOFIA has built a sophisticated website (www.kofia.or.kr) which discloses the pricing information to public and vendors. Information disclosed include name of the firm, branch number, type of transaction, counter party and other details about the securities traded. KOFIA publishes an average more than 2,000 transactions a day involving KW 10 to 15 trillion.

To keep the public informed about interest rate movement in benchmark bonds, KOFIA releases on a daily basis two important daily bond yields to the public.

The first one, the representative bond yield (RBY) represents a weighted-average yield of certain bonds in terms of trading volume. The second bond yield is the final quotation bond yield (FQBY) which is the final yield at which bonds are traded or the last yield quoted for daily transactions.

FQBYs of certain types of different bonds are regarded as benchmark yields in the Korean bond markets. FQBYs are currently released twice daily at 12:00PM and 4:00PM.

On December 4, 07, KOFIA launched BQS, the OTC Bond Quotation System, which is a system that collects and disseminates all of the data pertaining to quote information on the OTC trading. With the implementation of the system, quotes are collected in a single, centralized system.

This is expected to gradually contribute to better price discovery, and enhance transparency and liquidity in the secondary market.
The market rate formed through this system will function as a benchmark rate and improve the efficiency of the secondary market.

Under the existing supervision regulation of securities business, securities companies, banks, and specialized bond brokers are required to report to the KOFIA in real-time the OTC quotes for the bonds they hold.

The quote information collected is then released by the KOFIA in real-time. As of January 2008, eighty four financial institutions report their quotes to the BQS.

From February 27, 2009, the KOFIA has disclosed default rates and recovery rates to enhance the price discovery function of the high-yield bond market, develop new bond-related products, and to use as raw data for risk management.

In addition, from June 2009, it has announced real-time bond indices, enabling real-time assessment of the bond market and the development of new index-linked bond products including ETF. Related to this, the first Korean KTB ETF was listed on the KRX on July 29, 2009. As of Apr. 2012, 7 Types of Bond ETF listed and traded (Total value: about US$ 1.3 bill.)

[From KOFIA]

J. Listing of Bonds & MTNs

1. Criteria
   a. Rationale

   Bond listings mean that bonds issued on the Stock Market are allowed to be traded.

   * Financial Investment Services and Capital Markets Act, Article 390

   Article 390(Listing Regulations)
   ② Listing Regulations shall include matters falling under each of the following subparagraphs:
   1. Matters regarding listing standards and listing review of securities

   b. Advantages of Bond Listings

   • Improving public confidence in the issuing firm
   • Improving public confidence in the issuing firm by making public the company’s operations and information on bond listings
   • Used as substitute securities and collateral assets
   Used as the consignment guarantee money of stocks, futures, and options trading and as the deposit money and security deposit to be paid to the public institution
   • Selected to be incorporated as an investment for financial products
   Financial institutions like investment trusts, etc. incorporate mostly listed securities as constituents for funds

   c. Listing Criteria
Bonds are listed in accordance with the provisions specified in the Listing Regulation. The KRX lists the bonds whose listing has been requested after careful examination of listing eligibility.

<table>
<thead>
<tr>
<th>Classification</th>
<th>Initial listing of domestic bonds</th>
<th>Initial listing of foreign bonds</th>
</tr>
</thead>
<tbody>
<tr>
<td>Issuing corporation</td>
<td>Corporation with capital stock at least KRW 500 million. This requirement is not applied to secured bonds, mortgage bonds and asset backed securities</td>
<td>It should be a corporation listed on one of foreign exchanges. Listing of foreign stock or DRs on the Stock Market or KOSDAQ market of KRX. Must be a registered corporation as defined in the regulations of the Securities Exchange Act, Article 3.</td>
</tr>
<tr>
<td>Net Worth</td>
<td>-</td>
<td>Net worth more than KRW 10 billion. Capital should not have been impaired as of the end of the latest fiscal year.</td>
</tr>
<tr>
<td>Public offering or secondary distribution</td>
<td>The bonds should have been issued through public offering or secondary distribution</td>
<td>The bonds should have been issued through public offering or secondary distribution.</td>
</tr>
<tr>
<td>Total amount issued</td>
<td>It should be more than KRW 300 million. In case of secured bonds or mortgage bonds, it should be more than KRW 50 million.</td>
<td>It should be more than KRW 300 million. In case of secured bonds or mortgage bonds, it should be more than KRW 50 million.</td>
</tr>
<tr>
<td>Total Par value of unredeemed bonds</td>
<td>Total Par value of unredeemed bonds should be at least KRW 300 million. In case of secured bonds or mortgage bonds, it should be more than KRW 50 million.</td>
<td>Total Par value of unredeemed bonds should be at least KRW 300 million. In case of secured bonds or mortgage bonds, it should be more than KRW 50 million.</td>
</tr>
<tr>
<td>Uniform bond certificates</td>
<td>The bond certificates concerned should be the uniform certificates specified in the SEA</td>
<td>-</td>
</tr>
<tr>
<td>Denomination of bond certificates</td>
<td>In case of convertible bonds, they should be one denomination (KRW 100,000)</td>
<td>In case of convertible bonds, they should be one denomination (KRW 100,000)</td>
</tr>
<tr>
<td>Registered bonds</td>
<td>In case of convertible bonds, it should be the registered ones under the Bond registration Act</td>
<td>It should be the registered ones under the Bond Registration Act</td>
</tr>
<tr>
<td>Credit rating</td>
<td>-</td>
<td>Credit rating by a credit appraisal agency should be higher than BBB. * note: Table of corporate bond rating by domestic credit rating organization</td>
</tr>
</tbody>
</table>

* Government bonds, municipal bonds, and specific laws bonds are listed when received listing application without listing examination. However, the listing criteria are applied to the specific laws bonds that require filing of securities registration statement.

2. Procedure

a. Listing procedure

Listing application for bonds can be submitted over Internet, using the bond listing system in the KRX homepage or "http://bonds.sm.krx.co.kr".

The supplementary documents can be submitted by facsimile or when the securities registration statement is up-loaded through the bond listing system, the result can also be confirmed over Internet.
b. Listing of Government Bond

Government bonds are listed upon receiving the listing application, without listing examination.

Of the government bonds issued presently, the treasury bonds and foreign exchange stabilization bonds are listed on the issuing day and according to the regulations governing shelf listing of bonds, the national housing bond (1&2) is listed on the first day of each month.

Listing of the treasury bonds and foreign exchange stabilization bonds are handled by the Bank of Korea over Internet, and for the listing of the national housing bond (1&2), on the basis of the application for self listing for the bonds scheduled to be issued during the following year at the end of each year, the KRX lists the scheduled quantity on the first day of each month, and adjusts the listing value upon receiving the notice of issuance value following confirmation of bond issuance for the concerned month.

c. Listing of Municipal Bond

In common with government bonds, taking into account their public benefits, municipal bonds are listed without listing examination. Listing of shelf-listed municipal bonds, i.e., the provincial development bonds and local subway bonds, is handled in the same way as the national housing bonds (1&2), and listing of bonds issued through public offering is handled in the same way as the corporate bonds.

The documents required for listing application for provincial development bonds and subway bonds are an application for self listing and report on result of issuance, and
the documents required for listing of the municipal bonds issued through public offering include an application for listing, trust deed, underwriting agreement or sales contract, a copy of an agreement on offering on commitment (only in case where the concerned bonds are issued through indirect offering), etc. Listing application for bonds can be submitted over Internet.

d. Listing of Special Bonds

Listing requirements and methods for specific laws bonds differ depending on bond type.

i. Monetary Stabilization Bonds

In common with government bonds, listing application of the monetary stabilization bonds is made on the day of sale or bidding, and they are listed on the issuance day.

ii. Shelf listed bonds

Industrial financial bonds, Korea National Housing Corporation (land) bonds, and land development bonds are listed as shelf listed bonds in the same way as local subway bonds, which are municipal bonds.

That means that, on the basis of the application for self listing for the bonds scheduled to be issued in each month during the following year at the end of each year, the KRX lists the scheduled quantity on a fixed day (for example, on 27th of each month for industrial financial bonds), and adjust the listing value upon receiving the notice of issuance value following confirmation of issuance of bonds for the concerned month.

iii. Public bonds

Bonds of the public corporations are issued indirectly through securities firms. For their convenience, the issuing firms are allowed to compile all bonds issued during a month and submit the listing application for such bonds collectively by 10th of the following month.

iv. Presale bonds

Listing of presale bonds (the bonds are issued together after accumulating all bonds sold during a month, thus their issuing date is same, but sale dates are different), which are bank bonds, was handled as a shelf listed bond until June 2001.

However, with the abolition of the taxation regulations concerning the holding period in July 2001, the presale bonds are listed by giving different name to each sale date (with same issuing date).

v. Bonds requiring filing of the securities registration statement

Filing of the securities registration statement was exempted for the merchant bonds, card bonds, lease bonds, discount financial bonds, and new technology financial bonds, and such bonds issued during a month were accumulated and listing application was made by 10th of the following month.

However, with the amendment of the SEA in July 2001, the filing of the securities registration statement has become an obligation. Consequently, in accordance with
the bond issuance plan for a fixed duration (up to one year period), issuers of such bonds has to file an application for self listing to the FSC, and an application for additional self listing has to be filed every time when bonds are issued during the specified period.

Listing application should be made after filing the application for additional self listing.

**e. Listing of Corporate Bonds**

Corporate bonds are required to list on the issuing day. Issuing firms submit a listing application and the KRX lists the bonds after listing examination.

Listing application should be made after the FSC has accepted the securities registration statement.

**f. Listing of Foreign Bonds**

Foreign bonds refer to the bonds issued by a foreign legal entity (including the foreign corporations established in accordance with the foreign governments, foreign municipal government, foreign public organizations and foreign status and laws as well as the international financial bodies established by an international convention). Because of the difficulties involved in assessing the trustworthiness / soundness of foreign corporations, listing of foreign bonds requires a careful listing examination.

Accordingly, in order to ascertain the facts that issuing conditions of the bonds meet the requirements for investor protection and are compatible with the listing and trading systems of the KRX, as well as to enable initiation of appropriate measures, anyone who intends to list foreign bonds is required to consult with the KRX on such matters as listing procedures and time prior to submission of an application.

### 3. Application form

**a. Related documents**

The applicant for the initial bond listing must submit the initial bond listing application form (bond listing request for national bonds) and attached documents.

**b. Application form**

① Samples such as government bonds, municipal bonds, monetary stabilization bonds, and specific laws bonds that are continually issued for sale throughout the month are submitted only once but are omitted when issuing registered bonds.

② For indirect issuers, copies of the trust instrument, acceptance contract, or sales contract, collection consignment contract

③ Business description (including corrections to statements)

④ Financial statements and auditor’s reports for the past three business years

⑤ Auditor’s report on the financial statements of the most recent business year

⑥ Documents that verify the payment of bond

⑦ Miscellaneous documents deemed necessary by the KRX

* Exempted Documents
3~7 Exemptions: Municipal bonds of secondary distribution, specific laws bonds (except for specific laws bonds that submit the securities registration statement), and bonds that are exempted from filing the securities registration statement

4~5 Exemptions: guaranteed bonds and non-guaranteed bonds that submit business reports based on Article 186, Clause 2 of the Securities Exchange Act

2~5 Exemptions: If securities registration statement that has come into effect have been submitted

c. Application form for foreign bonds

① As defined in statutes or appropriate documents
② For indirect issuers, copies of the trust instrument, acceptance contract, or sales contract, collection consignment contract
③ Copy of the assignment contract as a listing representative
④ Auditor’s report, or comparable documents, on the financial statements for the past three business years
⑤ Copy of the credit rating report
⑥ Miscellaneous documents deemed necessary by the KRX

* Exempted Documents

1~6 Exemptions: If securities registration statement that has come into effect have been submitted

d. Methods for Submitting Documents

Mail, by means of someone, electronic document or fax

Among the accompanying documents that must be submitted, those that weren’t submitted at the time of the listing application may submitted within three days after the bond concerned is issued

4. Listing fees / annual dues

a. Rationale

The KRX collects listing fees from institutions that apply for bond listings.

The purpose of the fees that must be paid when listing is for the KRX to maintain the various expenses required to provide all sorts of services to the issuing institution. Included are listing fees and annual dues.

b. Listing Fees

i. Initial Listing Fees

The following amounts are applied for listing amounts classified by issue using face values when calculating initial listing fees for bonds.

However, for shelf listed bonds and non-shelf listed bonds, the monetary amount for listing bonds issued on the same day continuously throughout the month is calculated by assigning bonds issued on the same day as one issue by each listing request date. Listing fees are paid when the listing request is made, but for shelf listed bonds, they are paid when the results for the issue are announced.
### Listing Fees

<table>
<thead>
<tr>
<th>Listing amount (in billion KRW)</th>
<th>Listing fees (in thousand KRW)</th>
</tr>
</thead>
<tbody>
<tr>
<td>&lt;1</td>
<td>100</td>
</tr>
<tr>
<td>≥1 and &lt;2</td>
<td>150</td>
</tr>
<tr>
<td>≥2 and &lt;5</td>
<td>300</td>
</tr>
<tr>
<td>≥5 and &lt;10</td>
<td>700</td>
</tr>
<tr>
<td>≥10 and &lt;15</td>
<td>1,000</td>
</tr>
<tr>
<td>≥15 and &lt;25</td>
<td>1,200</td>
</tr>
<tr>
<td>≥25 and &lt;50</td>
<td>1,300</td>
</tr>
<tr>
<td>≥50 and &lt;100</td>
<td>1,400</td>
</tr>
<tr>
<td>≥100 and &lt;200</td>
<td>1,500</td>
</tr>
<tr>
<td>≥200 and &lt;500</td>
<td>1,600</td>
</tr>
<tr>
<td>≥500</td>
<td>1,700</td>
</tr>
</tbody>
</table>

#### ii. Listing change fees

Bond listing corporations that change listed bonds due to mergers, spin-off, or business transfers and corporate name changes are charged with change listing fees of 300 (in thousand KRW) per bond.

#### iii. Relisting fees

Bonds that are applicable to bond delisting standards due to bankruptcy, etc. are delisted. However, if the cause for delisting is solved and the bond is relisted, then fees of 300 (in thousand KRW) are charged per bond.

#### c. Annual dues

The total annual dues during the remaining repayment period for bonds must be paid in advance at the time of the listing application (for shelf listed bonds, annual dues are paid when the issue results are announced).

In this case, monetary amounts (rounded to the lowest 100 won) calculated by monthly installments (rounded down to the lower month) are used for remaining repayment periods of less than a year. If the remaining repayment period is greater than 5 years, then the monetary value is calculated based on 5 years.

The standard charges and fees for the annual dues of bonds are based on the listing date (relisting date) and charged 100 (in thousand KRW) for remaining repayment periods of one year per each issue.

However, for shelf listed bonds and non-shelf listed bonds, annual dues for the amount of bonds issued on the same day continuously throughout the month is based on the issuing date.

The dues are charged by assigning the amount of bonds issued on the same day month one issue and categorizing them by interest paid methods and by remaining repayment periods.
d. Fee Exemptions and Restoration

- Listing fees and annual dues: Government bonds, municipal bonds, and monetary stabilization bonds.
- Annual dues: Bonds that exist for less than a year from the listing date. Bonds that are issued by KRX securities trading members (excluding bond specialist members).
- Change listing fees: Imposed on listed bonds of corporations when change listings (changes to listings) due to changes to stocks and due to mergers of the listed corporation’s stock certificate occur.

e. Restoration

The KRX restores the listing fees and annual dues (pursuant to Clause 4) for bonds that are denied their listing applications.

Corporations that list bonds must follow the stipulations agreed to in the listing contract when their bonds are delisted during the remaining repayment period and have already been prepaid for.

According to the notifications for the cause of delisting and the restoration of annual dues, monthly installments up to the delisting date are deducted from the total annual dues paid and the remaining amount is restored to the corporation (rounded to the lowest 100 won).

K. Governing Laws of Bond Issuance

The Regulation on Securities Issuance and Disclosure (RSID), enacted in February 2009, is an FSC regulation that overhauled the former “Regulation on the Issuance and Disclosure of the Securities” by adding regulatory improvements and additional authorities entrusted by FSCMA.

To ensure the fairness of securities issuance and investor protection, RSID specifically defines items which investors should be notified of in the form of descriptions on the registration statement and investment prospectus, along with the forms and other documents they should accompany.

In particular, when it comes to the registration statements of collective investment securities and asset-backed securities, and the registration statement on mergers, business transfers and split-offs, split-and-mergers, comprehensive exchanges or transfer of stocks, RSID defines different specifics and required documents.

L. Related Legal and Regulatory issues behind the Market

In February 2009, Korea’s financial regulatory structure witnessed a fundamental change in its landscape with the enforcement of the Financial Investment Services and Capital Market Act (FSCMA).

Enacted in 2007 to promote a fair market competition, financial innovation and stricter investor protection, FSCMA drastically altered the regulatory framework of the Korean
capital market. With its implementation, the previous major capital market laws such as Securities and Exchange Act, Futures Trading Act, Korea Securities and Futures Exchange Act, Indirect Investment Asset Management Act, Trust Business Act and Merchant Banks Act were all abolished and replaced by FSCMA.

[from KOFIA]

M. Self-Governing Rules behind the Market

1. Self-Regulatory Organizations

a. Korea Financial Investment Association

The Korea Financial Investment Association (KOFIA) is an incorporated membership organization for the purpose of maintaining business order between members, assuring fair trade, protecting investors, and promoting the sound development of financial investment services.

Members of the Association are financial investment firms, general administration companies, collective investment scheme assessment companies, bond assessment companies and members under the conditions prescribed by the articles of the Association.

KOFIA aims to promote fair business practices among member companies, create a fair business culture in the securities trading market and maximize the function of investor protection.

As such, KOFIA undertakes such activities as self-regulation to protect investors and maintain market order among member companies; dispute mediation between members regarding their business activities; registration and management of investment advisers and managers; OTC trading management for non-listed stocks; and establishment of dispute mediation rules for industry’s self-mediation of conflicts.

b. Korea Exchange

The Korea Exchange is a stock company, which aims to fix and stabilize fair prices in the transactions of securities and exchange-traded derivatives, and facilitate the stability and efficiency of other transactions.

It established and operates the Stock Market, the KOSDAQ Market, and the Futures Market. Under FSCMA, the Stock Market is a market established for the trading of securities, such as debt securities, equity securities, beneficiary securities, investment contract securities, derivative-combined securities and securities depositary receipts. The KOSDAQ Market was established for the trading of specific securities, designated by FSCMA, such as corporate bonds and stocks.

Therefore the Stock Market and KOSDAQ Market have clear differences in terms of the kinds of stocks they deal in. The Futures Market is a market established by the Korea Exchange for the trading of exchange-traded derivatives.

The responsibilities of the Korea Exchange, include the establishment and operation of the Stock Market, the KOSDAQ Market, and the Future Market; transactions of securities and exchange-traded derivatives; transaction confirmation; debt acquisition; deduction; confirmation of settlement securities, settlement item, and settlement
amount; settlement execution guarantees; follow-up measures on settlement failure and settlement instruction as a result of transactions on the securities market and the derivatives market; report and disclosure of a listed corporation; and self-resolution of disputes arising from transactions in the Stock Market, the KOSDAQ Market and the Futures Market

[2010, Capital Market in Korea, p.320–321]
II. Primary and secondary market related regulated frameworks

A. Issuing Debt Instruments related regulations/rules

1. Disclosure requirements

**Article 123 (Preparation and Disclosure of Investment Prospectus)**
When an issuer publicly offers or sells securities in accordance with Article 119, the issuer shall file an investment prospectus (hereinafter referred to as “investment prospectus”), prepared in accordance with the manner prescribed by Presidential Decree, with the Financial Services Commission on the day on which the relevant registration statement becomes effective (or the day on which the supplements to a universal shelf registration statement are filed, in cases where the supplements to the universal shelf registration statement shall be filed in accordance with Article 119 (2)) and keep it at a place specified by Ordinance of the Prime Minister to make it available to the public for inspection. <Amended by Act No. 8863, Feb. 29, 2008>

No investment prospectus shall contain any description different from the one described in the relevant registration statement (including any supplements to a universal shelf registration statement under Article 119 (2); hereafter the same shall apply in this Chapter) or omit any description stated therein: Provided, that a description of the balance between confidentiality in corporate management, etc. and protection of investors, etc., as prescribed further by Presidential Decree.

An issuer of the collective investment securities specified by Presidential Decree shall file an additional investment prospectus separately from the one under paragraph (1) in accordance with the following subparagraphs, with the Financial Services Commission, and shall keep it at a place specified by Ordinance of the Prime Minister to make it available to the public for inspection: Provided, that such filling, keeping, and disclosure may be omitted, if offering or selling such collective investment securities is discounted: <Amended by Act No. 8863, Feb. 29, 2008>

A revised investment prospectus shall be filed at least once after the investment prospectus under paragraph (1) is filed within an interval prescribed by Ordinance of the Prime Minister; and

In cases where an amendment to registration is filed in accordance with Article 182 (8), an investment prospectus in which such amendment is reflected shall be filed within five days after a notice of amended registration is delivered.

[FSCMA, Chapter I in Part III]

2. Credit Rating requirements

**Regulation 11. Underwriting of Non-Guaranteed Bonds**
In the case of an underwriter underwriting non-guaranteed bonds, such bonds shall be those that have been rated by at least two (one agency, in the case of underwriting ABS issued in the form of bonds pursuant to the Act on ABS or in inevitable cases such as the business suspension of credit rating agencies) credit rating agencies from among those approved for the credit ratings business pursuant to the provisions of the Act on Use and Protection of Credit Information.
However, non-guaranteed bonds issued by foreign corporations, etc., shall be deemed as those rated in accordance with this provision if they are rated by two or more credit rating agencies (referring to international credit rating agencies as prescribed by the Governor of the Financial Services Commission in Item e of [§2 - 11(2)1] of the FSC's Regulations on Securities Issuance and Disclosure; the same hereinafter in this chapter).

[Chapter III in Regulations on Securities Underwriting Business]

3. Minimum lead time (number of business days) for registration approval

Article 120 (Effective Date of Registration Statement, etc.)

The registration of securities under Article 119 (1) and (2) (hereinafter referred to as “securities registration”) shall be effective on the day after the expiration of the time period prescribed by Ordinance of the Prime Minister, considering the type of securities or the characteristics of the transaction, etc., which shall begin on the day on which the registration statement is submitted and accepted by the Financial Services Commission. <Amended by Act No. 8863, Feb. 29, 2008>

The Financial Services Commission shall not refuse to approve a registration statement, unless it is not prepared in conformity with the prescribed form of the registration statement, there is any false description or representation in the registration statement concerning a material fact, or any description or representation of a material fact is omitted. <Amended by Act No. 8863, Feb. 29, 2008>

The effectiveness under paragraph (1) shall not include any effect of acknowledging that the descriptions of the relevant registration statement are true or correct, or the Government’s assurance or approval of the value of the securities.

An issuer of securities shall, when it intends to withdraw its securities registration, file a withdrawal statement with the Financial Service Commission no later than the day before the date set for offering to acquire or purchase the securities stated in the relevant registration statement. <Amended by Act No. 8863, Feb. 29, 2008>

[FSCMA, Chapter I in Part III]

4. Availability of Shelf Registration and Associated Documentation Requirements

If bond issuer uses the shelf registration, bond issuer must submit the “universal shelf registration statement” to the Financial Services Commission. The legal provision for shelf registration is stipulated at Article 119 (2) in FSCMA.

Article 119 (Registration of Public Offering and Sale)

... When a registration statement for a total amount of securities to be publicly offered en bloc over a certain period of time (hereinafter referred to as “universal shelf registration statement”) in accordance with the guidelines and methods prescribed by Presidential Decree, considering the type of securities, scheduled issue period, frequency of issuance, requirements for the issuer, etc., is submitted to and accepted accordingly by the Financial Services Commission, such securities may be publicly offered or sold without necessarily submitting a registration statement each time such securities are
publicly offered or sold during the period of time stated therein, notwithstanding paragraph (1). In such cases, the documents related to the universal shelf registration statement (hereinafter referred to as "supplements to universal shelf registration statement"), as prescribed by Presidential Decree, shall be submitted each time such securities (excluding collective investment securities, specified by Presidential Decree) are publicly offered or sold. <Amended by Act No. 8863, Feb. 29, 2008>

[FSCMA, Chapter I in Part III]

5. Regulated suspension period

The maximum of regulated suspension period is up to six months. The suspension period is imposed by FSS, if some financial investment institutions violate the regulation or the law in FSCMA.

B. Buying debt instruments (Investor’s regulation / rule) / (Secondary Market related)

1. Continuous disclosure rules or requirements
   Article 33 (Business Report and Public Disclosure, etc.)

A financial investment business entity shall prepare business reports for three, six, nine, and twelve months respectively from the commencement date of each business year, and shall submit them to the Financial Services Commission within the period of time prescribed by Presidential Decree, not exceeding 45 days after the lapse of each relevant term as specified above. <Amended by Act No. 8863, Feb. 29, 2008>

A financial investment business entity shall keep a summary of the business reports submitted under paragraph (1) containing the material facts of each business report for public disclosure, in the head office, branch offices, and sales offices for one year from the date on which the report is submitted to the Financial Services Commission, and shall also disclose it to the public through its Internet homepage, etc. <Amended by Act No. 8863, Feb. 29, 2008>

In the event that anything that is likely to produce a significant impact on the business management status of a financial investment business entity, such as occurrence of any massive financial scandal or non-performing claims, as prescribed by Presidential Decree for each type of financial investment business, the financial investment business entity shall report it to the Financial Services Commission, and shall disclose it to the public through its Internet homepage, etc. <Amended by Act No. 8863, Feb. 29, 2008>

A financial investment business entity shall submit reports indicating monthly business affairs in addition to business reports under paragraph (1) to the Financial Services Commission by the end of the next month. <Newly Inserted by Act No. 9407, Feb. 3, 2009>

Matters concerning the business reports submitted under paragraph (1), the descriptions contained in the document for public disclose under paragraph (2), and the public disclose of the business management status under paragraph (3), the reports submitted under paragraph (4) and other necessary matters shall be prescribed by Presidential Decree. <Amended by Act No. 9407, Feb. 3, 2009>
2 Restrictions for Investors

a. Licensing

Pursuant to Article 12 (1) of FSMCA, an entity that wishes to run a licensed financial investment business shall select all or a part of its business units for licensing from FSC. A single business unit can be defined through the combination of factors such as the types of financial investment business, the scope of financial investment products, and classes of investors.

More specifically, the constituents of financial investment business are the six types of investment business such as investment trading, investment brokerage, collective investment, investment advisory, trust, and discretionary investment business, and the product scope consists of securities, exchange-traded derivatives, and over-the-counter derivatives. Investors are divided into ordinary and professional investors.

In addition, in accordance with Article 18 (1) of FSCMA, an entity that wishes to operate a registered financial investment business shall create a single business unit by combining the aforementioned three factors and select all or part of the business units for registration with FSC as a financial investment business.

The Enforcement Decree of FSCMA sets forth the minimum level of net assets required to run each licensed or registered business unit based on the associated risk and the required level of investor protection for each service.

For example, a higher level of minimum net assets is required for investment trading and trust services, compared to investment brokerage and collective investment services, respectively. Likewise, as the registration of a business unit is a relaxed means of an entry, it requires a lower level of minimum net assets than a licensed business unit.

With regard to the financial investment instrument, over-the-counter derivatives require the highest level of net assets.

Between securities and exchange-traded derivatives, securities require a higher minimum level of net assets due to the more frequent release of new products on the market. In addition, the minimum net asset requirement is reduced in half of a financial investment firms to add more services, grow in size, and enhance their expertise through lowered entry barriers.

Based on the Enforcement Decree, if a financial investment company launches an investment trading service that handles debt securities, equity securities, beneficiary securities, derivatives – combined securities and securities depository receipts, the company should hold a minimum account of net assets of KRW50bn. But in the case of only managing debt securities, the net asset requirement is KRW20bn, while equity securities business (excluding collective investment securities) alone requires minimum net assets of KRW25bn.
Minimum net asset requirement for investment trading business

<table>
<thead>
<tr>
<th>Business area (Excluding underwriting)</th>
<th>Financial investment product</th>
<th>Minimum net assets (Unit: billion won)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Trading</td>
<td>Securities</td>
<td>20 / 10</td>
</tr>
<tr>
<td>Trading</td>
<td>Debt securities</td>
<td>8 / 4</td>
</tr>
<tr>
<td>Trading</td>
<td>State, local government and special bonds</td>
<td>3 / 1.5</td>
</tr>
<tr>
<td>Trading</td>
<td>Corporate bonds</td>
<td>4 / 2</td>
</tr>
<tr>
<td>Trading</td>
<td>Equity securities (excluding collective investment securities)</td>
<td>10 / 5</td>
</tr>
<tr>
<td>Trading</td>
<td>Collective investment securities</td>
<td>2 / 1</td>
</tr>
<tr>
<td>Trading</td>
<td>Repurchase agreement (RP)*</td>
<td>(Professional) 6</td>
</tr>
</tbody>
</table>

Note: 1) Securities mean financial investment instruments that comprehensively cover debt securities, equity securities, beneficiary certificates, derivatives-combined securities and securities depository receipts (Article 3 of FSCMA).
2) Debt securities include state bonds, local government bonds, special bonds, corporate bonds and corporate commercial papers.
3) Financial instruments for RP include government bonds, public offering bonds issued by listed companies and state-owned companies, guaranteed bonds, ABS and MBS for public offering and beneficiary certificates.

For the brokerage business, the minimum net asset requirement is KRW1bn with the amount halved to KRW500mn if the company only targets professional investors who require relatively lower levels of protection.
Based on this formula, a company that wants to carry out both brokerage and dealing will require total net assets of KRW 11bn, which is broken down to KRW1bn for brokerage and KRW10bn for dealing.

Minimum net asset requirements for investment brokerage business

<table>
<thead>
<tr>
<th>Business area</th>
<th>Financial investment product</th>
<th>Minimum net assets (Unit: billion won)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Brokerage</td>
<td>Securities</td>
<td>3/1.5</td>
</tr>
<tr>
<td>Brokerage</td>
<td>Debt securities</td>
<td>1/0.5</td>
</tr>
<tr>
<td>Brokerage</td>
<td>Equity securities (excluding collective investment securities)</td>
<td>1/0.5</td>
</tr>
<tr>
<td>Brokerage</td>
<td>Collective investment securities</td>
<td>1/0.5</td>
</tr>
<tr>
<td>Brokerage</td>
<td>Repurchase agreement (RP)</td>
<td>0.5 (Professional)</td>
</tr>
<tr>
<td>Brokerage</td>
<td>Exchange-traded derivatives</td>
<td>2/1</td>
</tr>
<tr>
<td>Brokerage</td>
<td>Exchange-traded derivatives (securities for underlying asset)</td>
<td>1/0.5</td>
</tr>
<tr>
<td>Brokerage</td>
<td>OTC derivatives</td>
<td>16/5</td>
</tr>
<tr>
<td>Brokerage</td>
<td>OTC derivatives (securities for underlying asset)</td>
<td>5/2.5</td>
</tr>
<tr>
<td>Brokerage</td>
<td>OTC derivatives (non-securities for underlying asset)</td>
<td>5/2.5</td>
</tr>
<tr>
<td>Brokerage</td>
<td>OTC derivatives (currency /interest rates for underlying asset)</td>
<td>2/1</td>
</tr>
<tr>
<td>Brokerage (ECN)</td>
<td>Listed securities</td>
<td>15/7.5</td>
</tr>
<tr>
<td>Brokerage (OTC bond transaction)</td>
<td>Securities, debt securities</td>
<td>3 (Professional)</td>
</tr>
</tbody>
</table>

Note: 1) Securities mean financial investment instruments that comprehensively cover debt securities, equity securities, beneficiary certificates, derivatives-combined securities and securities depositary receipts (Article 3 of FSCMA).
2) Debt securities include state bonds, local government bonds, special bonds, corporate bonds and corporate commercial papers.
3) Financial instruments for RP include government bonds, public offering bonds issued by listed companies and state-owned companies, guaranteed bonds, ABS and MBS for public offering and beneficiary certificates.

For the collective investment business, a company must have minimum net assets of KRW8bn to run all types of funds such as equity funds (including MMF), real estate funds, special assets funds, and mixed assets funds. However, only KRW2bn is required to run a single type of fund, such as real estate funds or special assets funds.

In the trust business, net assets of KRW25bn are required if a financial investment company is to manage all types of trust properties, while monetary trust alone requires only a minimum of KRW13bn in net assets.

For registered businesses such as investment advisory and discretionary investment services, minimum net assets of KRW500mn and KRW1.5bn are required,
respectively.

In addition, if a bank or an insurance company wishes to offer financial investment services concurrently, the minimum net asset requirements for the services should be examined based on an amount with the capital requirements for banking or insurance business (as prescribed in the banking act or the insurance act) deducted.

Minimum net asset requirement for collective investment business/trust business/investment advisory-discretionary investment business

<table>
<thead>
<tr>
<th>Business area</th>
<th>Financial investment product</th>
<th>Minimum net assets (ordinary and professional)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Collective investment</td>
<td>Securities collective investment scheme (CIS)</td>
<td>8 / 4</td>
</tr>
<tr>
<td></td>
<td>Real estate CIS</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Special asset CIS</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Mixed asset CIS</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Short-term finance CIS</td>
<td></td>
</tr>
<tr>
<td>Collective investment</td>
<td>Securities CIS</td>
<td>4 / 2</td>
</tr>
<tr>
<td></td>
<td>Short-term finance CIS</td>
<td></td>
</tr>
<tr>
<td>Collective investment</td>
<td>Real estate CIS</td>
<td>2 / 1</td>
</tr>
<tr>
<td>Collective investment</td>
<td>Special asset CIS</td>
<td>2 / 1</td>
</tr>
<tr>
<td>Trust</td>
<td>Money, securities, monetary claims, movables,</td>
<td>25 / 12.5</td>
</tr>
<tr>
<td></td>
<td>real estate, rights related with real estate,</td>
<td></td>
</tr>
<tr>
<td></td>
<td>intangible property rights</td>
<td></td>
</tr>
<tr>
<td>Trust</td>
<td>Money</td>
<td>13 / 6.5</td>
</tr>
<tr>
<td>Trust</td>
<td>Securities, monetary claims, movables, real estate,</td>
<td>12 / 6</td>
</tr>
<tr>
<td></td>
<td>rights related with real estate,</td>
<td></td>
</tr>
<tr>
<td></td>
<td>intangible property rights</td>
<td></td>
</tr>
<tr>
<td>Trust</td>
<td>Movable, real estate, rights related with real</td>
<td>10 / 5</td>
</tr>
<tr>
<td></td>
<td>estate</td>
<td></td>
</tr>
<tr>
<td>Investment advisory</td>
<td>Securities, exchange-traded derivatives, OTC</td>
<td>0.5 / 0.25</td>
</tr>
<tr>
<td></td>
<td>derivatives</td>
<td></td>
</tr>
<tr>
<td>Discretionary</td>
<td>Securities, exchange-traded derivatives, OTC</td>
<td>1.3 / 0.75</td>
</tr>
<tr>
<td>investment</td>
<td>derivatives</td>
<td></td>
</tr>
</tbody>
</table>

3. Definition of Qualified Institutional Investors, Professional Investors

The QIB system in Korean bond market is now under the investigation by the Government to implement it.

4. Non-resident requirements / restrictions

a. Foreign investor registration

Foreign investors who wish to acquire or dispose of securities listed on the securities market, or securities offered or sold for listing, must register with the Financial Supervisory Service (FSS).
The documents required by FSS should be submitted in person or through a local agent and an investment registration certificate (IRC) will be issued.

After submitting an IRC, a licensed local investment dealer or investment broker may open an account for securities trading on behalf of foreign investors.

b. Investors subject to registration

Generally, an individual of foreign nationality who has not maintained residence in Korea for more than six months will be subject to registration if he or she intends to invest in listed securities. The same applies to corporations.

Any corporation that does not have an office in Korea and was established according to foreign laws must register in order to invest in listed securities in Korea.

This means that a citizen residing outside Korea need not register for an IRC because of his or her Korean nationality.

However, foreign corporations (local subsidiaries) established by Korean nationals are viewed as foreign entities; therefore they must register with FSS for an IRC.

In addition, the main office and branch offices (except branch offices established within Korea) of a foreign corporation are viewed as a single foreign entity and are only required to have one IRC issued.

In the case of funds, however, a master fund and sub-fund cannot be registered together according to Article 6-10(2) of the Regulations on Financial Investment Business, in order to ensure the effectiveness of investment registration.

If they are registered together, a single beneficiary owner may eventually have more than two certificates.

However, when a master fund is not registered, each sub-fund is able to register individually since these sub-funds are considered separate beneficiary owners.

[2010, Capital Market in Korea, p.233~234]

C. Taxation Framework and Tax requirements

1. Financial investment instrument and Tax

   a. Taxable Income

      According to Income Tax Act (ITA), “interest and discount amounts” are considered taxable interest income.

      Bonds, etc. are usually issued at par or at discount. Bonds issued at par day interest on a quarterly or yearly basis to bondholders based on the coupon rate, considering the market interest rate at the point of issuance.

      Bonds issued at discount pay the principal and amount of interest simultaneously at the point of maturity.
The term “discount amount” in this context means an amount of interest paid at the point of maturity of the bonds issued at discount. That amount shall be the difference between the amount of redemption at maturity and the value of bonds discounted by the market interest rate at the point of issuance.

The taxable discount amount stipulated in ITA only refers to issuance discount (the amount according to the market interest rate at the point of bond issuance), not the market discount (the amount according to the market interest rate at the point of early bond redemption).

If a person redeems their bonds before maturity, they have to pay tax on the amount of interest accrued during possession of the bonds. For instance, if an investor who has bought 3-year discount bonds with a KRW3mn amount of discount wants to sell the bonds after only a year of possession, out of the total discount amount of KRW3mn, KRW1mn—the discount amount allocated for one year of possession—is the interest income liable for taxation. (This is referred to as the holding period tax system for bonds.)

Usually both the interest and discount amount of bonds are taxable, except when they are 1) government bonds; 2) industrial finance bonds; 3) deposit protection fund bonds and compensation fund bonds for deposit protection fund bonds; and 4) monetary stabilization bonds issued by the Bank of Korea on the open market. In these cases, to help promote and develop the government bond market, only the amount of interest accrued by the coupon rate exclusive of the discount amount if considered to be taxable interest income according to Subparagraph 2 of Article 22-2 of EDITA.

Furthermore, if a person transfers his/her bonds to another person before maturity, they could accrue capital gains due to the interest rate difference between the interest rate at the point of bond issuance and at the point of the transfer.

But Korea's taxation law do not levy tax on capital gains accrued from the transfer of bonds, etc.

When calculating taxable income, the amount of interest and dividend income shall be included in the total gross income accrued during the corresponding year according to Article 16 (2) and Article 17 (3) of ITA. Therefore necessary expenses are not recognized as expenses.

b. Receipt date of income

The date of receipt of income from bond interest shall be the date of receipt of such payments for interest and discount amounts for bearer public bonds, and the payment date under the agreement for interest and discount amount in the case of non-bearer public bonds, according to Subparagraph 2 and 3 of Article 45 of EDITA.

The receipt income accrued from coupon interest shall be the date of coupon, which is the receipt date of such payment.

As for the discount, the receipt date of income shall be the date of maturity, which is the receipt date of such payment.

In the case of the sale of bonds before maturity, the receipt date of income from interest shall be the sale date of the relevant bonds.
Therefore, when discount bonds are sold before maturity, the receipt date of income from the sale of the relevant bonds shall be the sale date, and if the bonds were redeemed at maturity, the date of redemption at maturity shall be the date of income from such payment according to Subparagraph 10 of Article 45 of EDITA.

Meanwhile, in the case of commercial notes or cover notes with short maturity terms traded by the passbook in custody, the receipt date of income shall be the date of discount sale if the owner of the notes decides to pay withholding tax on the same day. (Such bonds are referred to as prepaid interest bonds.)

[2010, Capital Market in Korea, 265-267]
III. Trading of Bonds and Trading Market Infrastructure

A. OTC trading of Bonds

The OTC market accounts for 80% of the Korean bond market. Before the Korean government made it mandatory for Primary Dealers (PD) to deal in the exchange market in order to develop the KTB market (in October 2002), the OTC market accounted for 98–99% of all bond trading.

The main participants in the OTC bond market are institutional investors, including banks, asset management companies, pension fund managers and insurance companies. Institutional investors trade bonds through financial investment firms that serve as brokers. In other words, each institutional investor presents an ask and a bid price to the financial investment firms they trade with, and the investment firm matches the ask price and bid price to establish a deal.

The investment firms, which serve as brokers, exchange offers and bid prices among themselves, thereby facilitating trading. In other words, financial investment firms are central to facilitating bond trading in the OTC market among institutional investors.

KOFIA introduced the OTC Bond Quotation System (BQS) in collaboration with the Financial Supervisory Commission. BQS was introduced in order to increase transparency in the OTC bond market.

B. Exchange Trading of Bonds

a. Ordinary Bond Trading System

i. Bonds eligible for trading

All bonds listed on the KRX, such as government bonds, municipal bonds, specific laws bonds, convertible bonds (CB), bonds with warrants (BW), exchangeable bonds (EB), corporate bonds, etc. are eligible for trading.

ii. Trading hours

It is from 09:00 to 15:00 every day except holidays and Saturday.

iii. Offer price
Price quotations are accepted and time for receiving quotation is from 08:00 to 15:00. Quotation price, quotation quantity and trading units are classified below as per equity-linked bond, general bond, foreign currency bond, and there is no price change limit.

<table>
<thead>
<tr>
<th>Classification</th>
<th>Equity-linked bond</th>
<th>General Bond</th>
<th>Foreign currency bond</th>
</tr>
</thead>
<tbody>
<tr>
<td>Quotation price unit</td>
<td>KRW1</td>
<td>KRW1</td>
<td>1 point</td>
</tr>
<tr>
<td>Quotation quantity unit</td>
<td>Face value</td>
<td>Face value</td>
<td>10,000 point</td>
</tr>
<tr>
<td></td>
<td>KRW 10,000</td>
<td>KRW 10,000</td>
<td></td>
</tr>
<tr>
<td>Trading unit</td>
<td>Amount of bond note (min. face value KRW 100,000)</td>
<td>Face value KRW 100,000 (small-lot/retail bond: KRW 1,000)</td>
<td>10,000 point</td>
</tr>
</tbody>
</table>

iv. Price determination in individual competitive auction with single price (simultaneous offer trading)

Under this system all the quotations, received in a certain span of time, are deemed to have been received at the same time and the trading is made in single price which then shall be applied to initial price determination or the same occurring after resumption of either the market or trading (applying quotations received for 10 minutes since resumption).

(1) In the above case, the trade shall be executed between the matched quotations as follows
- The total quantity of offers with the price lower than the matched price and the total quantity of bids with the price higher than the matched price
- With regard to bids and offers at the matched price, the quantity mentioned below:
  ① total quantity of either bid or offer quotations at the matched price; and
  ② Among the quantities of quotations on the counter side, the quantity above the trading unit of the issue concerned.

(2) Priority of simultaneous quotation is as follows
- Price priority
  - In case of same price range, the quotations for customer account transactions have priority over the quotations for proprietary account transactions
- Quantity priority per quotation
  - The order of quantity allocation (10 times of trading unit → 100 times → 1000 times → a half of the residual → the total residual quantity)

v. Price determination in multiple price auction (continuous auction)

In case the lowest offer price matches the highest bid price among the competitive bids and offers, trading shall be made at the price of quotation received first, and trades between the matching bids and offers are executed according to the priority of quotations (priorities in price & time).

vi. Reported trading system

When the members request the KRX to execute a trade between the bid and offer quotations of which the issue of debt security, price and quantity are the same, the KRX execute such trade at such price and quantity.

(1) How to make a report
To input a report in the KRX’s system through the member’s system. The KRX executes the reported trading between corresponding quotations and at the same time it considers settlement is finished.

vii. Settlement

<table>
<thead>
<tr>
<th>Item</th>
<th>Descriptions</th>
</tr>
</thead>
<tbody>
<tr>
<td>Kind of trading</td>
<td>Applicable only to the same day settlement (T+0) trading</td>
</tr>
<tr>
<td>Settlement between investors and securities company</td>
<td>By 15:30 of settlement date</td>
</tr>
<tr>
<td>Time limit of settlement</td>
<td>In case of registered bond, registration notice or registration certificate shall replace the sold bonds, and required documents for the change of registration shall be attached.</td>
</tr>
<tr>
<td>Collection of commission for customer account trading</td>
<td>If trading is made through entrustment of selling or buying from an investor, a member company shall collect commission according to the rates reported to the KRX</td>
</tr>
<tr>
<td>Settlement by a member</td>
<td>By 16:00 of settlement date</td>
</tr>
<tr>
<td>Time limit of settlement</td>
<td>A member has to make a payment to settlement agency prior to time limit after netting. Settlement of foreign currency bond shall be made in KRW conversed by basic rate on the settlement date according to Foreign Exchange Control Regulation</td>
</tr>
<tr>
<td>Settlement method</td>
<td>If it is impossible to deliver the traded bonds due to defective bonds, selling small-lot bond, foreigner’s selling or selling bonds with low liquidity, the securities delivery may be replaced by Securities Delivery Bill issued by the KRX.</td>
</tr>
</tbody>
</table>

b. Small-lot public Bond Trading System

i. Small-lot bond standard

Small-lot bond means the one issued in that month and in the previous month based on trading date and its amount is less than KRW50,000,000 at face value per account (per person in case of common account).

ii. Applicable bonds

- Type-I National Housing Bonds
- Seoul Subway Debentures & Seoul Regional development debentures
- Public bond for community development issued by special city, metropolitan cities & provinces according to Regional Public Enterprise Act
- Provincial subway debentures (Busan, Daegu, Daejon, Kwangju, Incheon)

iii. Market concentration trading system of small-lot bond

Market concentration trading system of small-lot bond was introduced for the purpose of improving convenience of buyers of the "add-on" fractional bonds and mitigating personal burden by way of raising easier exchange of bonds which are to be bought by persons at the time of registration of real-estate or automobile.

Taking into consideration liquidity of bonds, eligible bonds in this system are the bonds having been issued in that month or in the preceding month and the quotation of trading is less than 50 million Won per account (or per person in case of common account).

(1) Report of small-lot bond self-trading
In spite of the above system, if trading price of small-lot bond is above market price or made after trading hours, it is possible to have self-trading, with limitation to the trading with settlement in that day, outside of market on the basis of reported market yield,
and in this case the member is liable to report the KRX of trading hour, name of issue, quantity and price (yield).

(2) Exclusive member for buying small-lot bond
In order to have smooth trading the KRX nominates, among member companies, exclusive members for buying small-lot bond who submit compulsory bid, which is being run with 20 firms as of March 2010.

(3) Reported market price system
Reported market yield means the one calculated by the KRX; arithmetic average price disregarding high price of 10% and low price of 20%. the KRX calculates the said ratio when exclusive member company report desired price for the purchase, in order to enhance easier exchange by persons who are to compulsorily purchase the “add-on” fractional bonds and to promote consumption of bonds based on market fair price. Reported market price is applied to trading at the time of market closing of the next day so that a person can dispose public bonds owned by him at this price.

iv. Trading rules especially applicable to small-lot bond.
Following table shows trading rules especially applicable to small-lot bond.

<table>
<thead>
<tr>
<th>Item</th>
<th>Descriptions</th>
</tr>
</thead>
<tbody>
<tr>
<td>Common account for small-lot bond only</td>
<td>One-time trading for the “add-on” fractional bonds by an individual is possible through common account only for small-lot bond under the name of a member without opening a separate account</td>
</tr>
<tr>
<td>Bid price per kind of bond</td>
<td>Seoul subway debentures, Seoul regional development debentures and provincial subway debentures shall be classified into categories per same issuance date, and their bid prices are submitted as one group</td>
</tr>
<tr>
<td>Trading unit</td>
<td>Face value KRW 1,000</td>
</tr>
<tr>
<td>Priority of simultaneous quotation</td>
<td>KRW10million → KRW50million → KRW300million → KRW500million → the residual</td>
</tr>
<tr>
<td>Trading at market closing</td>
<td>Single price by reported market price of previous day shall be applied to trading from 20 minutes prior to closing till market closing</td>
</tr>
</tbody>
</table>

c. Primary Dealer Trading System
i. Bonds eligible for trading

Government bonds are traded exclusively in the special market and applicable bonds are Korea treasury bonds (KTBs), monetary stabilization bonds, and KDIC bonds. The details are shown below.

<table>
<thead>
<tr>
<th>Item</th>
<th>Details</th>
</tr>
</thead>
<tbody>
<tr>
<td>Benchmark KTBs</td>
<td>The most recently issued (on-the-run) KTBs in their respective maturity ranges. Primary dealers are required to perform market making for the benchmark KTBs.</td>
</tr>
<tr>
<td>Non-benchmark KTBs</td>
<td>KTBs other than the benchmark issue (off-the-run issues)</td>
</tr>
<tr>
<td>Monetary stabilization bonds</td>
<td>The most recent two MSB issues whose outstanding amounts are KRW 200 billion or more (among 1 year and 2 year maturity of MSBs)</td>
</tr>
<tr>
<td>KDIC bond</td>
<td>The most recent two 5 year KDIC bonds issues whose issuance amounts are KRW 200 billion or more</td>
</tr>
</tbody>
</table>

ii. Trading hours and Quotation Price

(1) Trading hours
Trading hours are from 09:00 to 15:00 for specialized market of government bonds and holidays are public holidays, Labor day, Saturday, 1 day at the end of the year, and other necessary days designated by the KRX.

(2) Quotation
Price-based limit quotation is used in this market. The quotation tick-size is KRW1, quotation quantity unit is face value KRW10,000 and trading unit is KRW1 billion.

(3) Kinds of quotation
Quotation is divided into market making quote and trading quote, and the former is further divided into two-way market making quote and one-way market making quote.

Two-way market making quote is the one that a primary dealer or a preliminary primary dealer submits buying and selling quote simultaneously while one-way market making quote is the one that a bond dealer (general dealer) submits selling or buying quote.

Trading quote means one-way quote that a participant submits to trade with market making quote.

In case of customer account trading, only one-way market making quote and trading quote are available

iii. Trading execution & settlement

The specialized market of government bonds adopts full automatic trading system based on internet order environment of KTS (KRX Trading System for government securities) in accordance with the individual competitive trading principle of multiple prices (simultaneous quotation not available).

Multilateral netting settlement & collective settlement are applied thereto so that in spite of innumerable trading by participants, it is possible for the KRX to minimize quantities of settlement bonds and the needed money.

At present payment adopts fund transfer method through BOK-Wire while settlement of government bonds adopts transfer method between deposit accounts at KSD.

Settlement period is T+1 (or T+2 for trading on the preceding day of reserves day) and time limit is 16:00 of the settlement day.

(1) Trading execution & settlement (summary)

- method of trading execution
  ✓ Full automatic trading method using internet order environment, and individual competitive trading principle of multiple prices (simultaneous quotation not available) to be applied
  ✓ settlement method (multilateral netting settlement & collective settlement)
  ✓ payment : fund transfer method through BOK-Wire
  ✓ settlement of government bonds : transfer method between deposit accounts at KSD

- settlement period & time limit
  ✓ settlement period : T+1 (or T+2 for trading on the preceding day of reserves day)
  ✓ time limit : 16:00 of the settlement day

iv. Participants in government bonds market

The government bond dealers such as the securities companies and banks which have obtained the permit from the government and are the members of the KRX, and ordinary institutional investors, such as the pension funds, insurance companies and asset management companies, participate in the government bond market.
Depending on their functions, the government bond dealers are categorized into the primary dealer, ("PD") and the ordinary dealer ("dealer").

The PDs have the rights to directly participate in the underwriting of KTBs in the primary market, but are required to act as market maker in the KTS of the KRX.

The Dealers are able to participate in the KTS of the Korea Exchange, but not allowed to directly underwrite KTBs in the primary market. There are 20 PD companies as of the end of December 2010.

v. Primary dealer System

Primary dealer is rendered benefit such as preferential bidding opportunity in issuance market of government bonds, bidding on behalf of non-competition bidding participants, take-over of government bonds and financial support, and meanwhile, the PD is a market maker who takes over more than 5% of total government bonds issued and performs market making duties in specialized market for government bonds.

PPD shall be nominated as a PD one year after its appointment of PPD by the minister of MOSF if the agency submits application for PD, satisfies following requirements.

<table>
<thead>
<tr>
<th>Item</th>
<th>Details</th>
</tr>
</thead>
<tbody>
<tr>
<td>Financial soundness</td>
<td>Securities firm: net capital ratio for business &gt;= 350%</td>
</tr>
<tr>
<td></td>
<td>Bank, merchant bank: BIS net worth ratio &gt;= 10.0%</td>
</tr>
<tr>
<td>Dealing manpower</td>
<td>More than 5 persons with more than 3 year experience</td>
</tr>
<tr>
<td>Research manpower</td>
<td>More than 3 persons with more than 3 year experience</td>
</tr>
<tr>
<td>Back-office manpower</td>
<td>More than 4 persons with more than 1 year experience</td>
</tr>
<tr>
<td>Business period of government bonds dealing</td>
<td>More than 2 years from permission date for government bond dealer to the application date for PPD</td>
</tr>
</tbody>
</table>

C. Bond Repurchase Market

1. REPO Trading System

   a. Bonds eligible for trading

   Securities which can be transacted by REPO are bonds, stocks, CP, CD and MBS, however, transaction with REPO at the KRX market is limited only to certain bonds listed below. The reason is to secure stability of REPO transaction through restriction of the objects to the ones with low risk, high liquidity, diversified investor base and stable cash flow.

   Accordingly, excluded from REPO transaction are such bonds as redemption-by-installment bond, floating rate note except Korea treasury bond, equity-related bond, mortgage bond, privately-offered bond, subordinate bond, asset-backed bond, etc.

   In other words, tradable securities in the KRX REPO market are government bonds (treasury bond, foreign exchange stabilization bond), specific laws bond (monetary stabilization bonds, KDIC bond) and blue-chip company bond (credit rating over AAA) that satisfy aforementioned requirements.

<table>
<thead>
<tr>
<th>Classification</th>
<th>Applicable Items</th>
<th>Requirements</th>
</tr>
</thead>
<tbody>
<tr>
<td>Government bonds</td>
<td>Treasury bonds</td>
<td>More than KRW 200 billion of outstanding amount</td>
</tr>
<tr>
<td></td>
<td>Foreign exchange stabilization bond</td>
<td>Vanilla bond</td>
</tr>
</tbody>
</table>
b. Trading period (kinds)

Most markets of advanced countries generally adopt term REPO which specifies trading period at the contract date of REPO, and most of the periods are within 1 month. Term REPO is applied to the KRX REPO market following international tendency and 8 terms (1-day, 2-day, 3-day, 4-day, 7-day, 14-day, 21-day, and 30-day), having less than one month trading period with abundant liquidity, 60-day and 90-day REPO are available.

c. Trading (submission of quotation) hours

Quotation receiving & trading time at REPO market of the KRX is from 09:00 to 15:00 same as that of KTS.

d. Quotation Price

According to the characteristic of REPO trading, repo rate is applied to quotation in the REPO market and the repo rate is quoted in yield terms, to two decimal places. Quotation quantity unit & trading unit are KRW10,000 and KRW5 billion respectively.

Only designated quotations are applicable in the case of REPO selling, while both designated quotations (kind of special collateral quotations) and non-designated quotations (kind of general collateral quotations) are accepted in the case of REPO buying.

Participant in the market places orders to the KRX through Web-Browser installed in his/her own PC.

e. Participants in REPO market

No restriction is imposed on participation in REPO market for REPO trading made at OTC because it is made through a broker or directly between parties concerned, but those who are entitled to participate in the KRX REPO market are same as direct participants of KRX trading system for government securities so as to effectively support dealer financing and to promote link-trading like arbitrage trading between markets.

That is, security's members & bond specialist members (banks) of KRX only can participate in the market, To participate in REPO market every participant has to follow the following procedures: permission of trading on bonds (the Financial Service Commission) → acquisition of membership of the KRX → submission of agreement of REPO trading to the KRX → registration as participant → acquisition of electronic authentication.

In addition, the government has also participated in the market since June 2nd, 2003 in accordance with introduction of REPO trading system for KTB.

f. Trade execution in REPO market

i. Trade execution
The OTC market is accompanied by time and cost resulting from observation of quotation due to non-concentration of quotation information, and in order to improve such problem KRX REPO market adopts, as a standardized intra-market trading, an individual competitive trading (perfect competition trading) with multiple prices which aims to secure smooth contract trading and transparency of trading through concentration of quotations (only principle of price/time priority is applied without individual competitive trading with single price.).

Namely, quotations submitted by participants are collected in the screen of REPO trading system at the KRX as per price range and in the order of submission, and then trade execution is made according to perfect competition trading method by multiple prices.

Furthermore, designated buying quotations in the quotation book (Refer to terminology of intra REPO market ) shall compete selling quotations for same item, and non-designated buying quotations are able to compete all kinds of selling quotations. Trading shall be realized at repo rate of the preceding quotation if there comes an agreement between selling quotation at the highest repo rate and buying quotation at the lowest repo rate.

Generally speaking, contract price (= repo rate) in REPO market has a tendency to be formed higher than rediscount rate of BOK but lower than interest of unsecured short-term financial market (call rate). And start leg price is not changed for the period until repurchase date in spite of substitution/exchange of bonds. (Fixed repo rate).

ii. Money for trading

As per money to be paid by buyer to seller in consideration of trading bonds according to the contract, it is calculated through applying haircut to market value of the bonds. The money for trading mentioned here is a fund to be lent by a buyer to a seller and it shall be the calculation basis of repurchase interest, and the seller shall pay the same money back with repurchase interest to buyer on repurchase date.

In case of REPO trading of the KRX, market value of object bond shall be calculated on the basis of the price of a fair evaluation agency and a buyer of REPO (lender of money) is required to hold excess security according to haircut.

**Trading amount = trading bonds (total face value) × market value/100 ÷ Haircut**

* market value: As the value calculated on the basis of bond par value KRW10,000, this means the simple arithmetic average of evaluation value which is the result of re-calculation, with due regard to transition period until the application day, of yield of the said bond to be announced by market value evaluation agency for evaluation of trading bonds and margin bonds.

* Haircut: As the discount rate for taking risk of price fluctuation during REPO transaction period, it means the ratio to be claimed by a buyer to a seller and it has function of initial margin.

**g. Closing of trading**

i. Settlement at REPO market

As a clearing agency for the securities based on the Capital market and financial investment Act, the KRX guarantees performance of settlement in relation to REPO
transaction and therefore, it plays a role as CCP (Central Counter Party) of seller and buyer respectively as far as settlement is concerned.

Additionally, it provides each party concerned with buy-back service for agreement of non-repurchase since execution of REPO trading (Tri-party Agent). Therefore, participants may participate in REPO market free from worry about settlement default.

<table>
<thead>
<tr>
<th>Item</th>
<th>Descriptions</th>
</tr>
</thead>
<tbody>
<tr>
<td>Settlement and repurchase agency</td>
<td>KRX (settlement guarantee)</td>
</tr>
<tr>
<td>The KRX (settlement guarantee)</td>
<td>Settlement by netting after unifying trading repurchase and additional deposit on that day</td>
</tr>
<tr>
<td>Settlement method</td>
<td>Cash payment: transfer through BOK-wire based on data calculated/informed by the KRX &lt;br&gt;Securities delivery: transfer through Safe System of KSD based on data calculated/informed by the KRX</td>
</tr>
<tr>
<td>Time limit settlement (on that day)</td>
<td>Trading on that day: trading day 16:00 &lt;br&gt;Repurchase on that day: repurchase date 16:00 &lt;br&gt;Additional deposit: accrual day of deposit 16:00</td>
</tr>
</tbody>
</table>

ii. Return of dividend

If dividend occurs from trading bonds during REPO trading period, the buyer should pay back the pertinent dividend to the seller according to the contract. Time of pay-back is the day of accrual in case of classic REPO adopted by the KRX and on the other hand, buyer returns it after deduction from repurchase amount in case of sell/buy-back.

Meantime, in most advanced countries withholding tax is not levied on financial income. Therefore, their procedures of dividend return are simple, however, the procedures in Korea who maintains withholding system on financial income are rather complicated in case of REPO trading, which results in restriction of trading.

iii. Marking to market

Marking to market means a series of procedures to maintain value of securities on a proper level through collecting additional deposit after calculating disclosed risk of one or the other party’s all agreement of non-repurchase with the same party in preparation of price fluctuation of trading bonds per trading day in order to guarantee settlement performance of REPO trading.

In marking to market, there are such methods as direct execution method between parties, the one acted by Tri-party Agent and the other one executed by CCP (Central Counter Party) of a international trend.

In case of REPO trading of the KRX, the KRX shall play a role of CCP for both parties and shall be responsible, as a repurchase agency, for doing marking to market and collecting additional deposit when disclosed to risk.

iv. Repurchase amount

This means the money to be paid to a buyer by a seller according to trading agreement and it is calculated as follows

\[
\text{Repurchase amount} = \text{Trading amount} \times (1+\text{repo rate} \times \text{Repo transaction period}/365)
\]

h. Settlement by cash
Such a thing might happen that a person, who is to pay back trading bonds or maintenance margin security on repurchase date, meets an uncontrollable situation being unable to secure bonds due to lack of liquidity of object bonds in spite of his sufficient financial ability to pay.

As such it might be difficult for some of dealers to make bonds settlement and adverse affect of such settlement default might be widely spread if the situation is left without any measures so that the KRX, for the purpose of preventing the same situation, has a system of settlement by cash in place of settlement by bonds under the condition of imposing adequate penalty subject to agreement of both seller and buyer.

Rate of penalty depends on premium, required for re-buying the corresponding bonds by the other party, and other market situations.

i. Settlement at REPO market

REPO trading shall expire if repurchase date arrives. The contract expires on repurchase date in case of normal arrival of expiration but if any of following causes occurs either on trading bonds or on a party, then the date of the occurrence shall be the repurchase date for stabilization of REPO transactions and the contract shall be terminated earlier than the original date.

In both cases, normal arrival of repurchase date and REPO seller’s refusal of exchange, contract shall be expired through exchanging trading bonds and repurchase amount.

In case of settlement default by a party, however, all the contracts between the parties shall be able to be settled by cash. As to the case of REPO trading of the KRX, the KRX as CCP shall pay instead the shortage money resulting from settlement of cash and file a claim against the defaulting party to get appropriate compensation.

<table>
<thead>
<tr>
<th>Item</th>
<th>Descriptions</th>
</tr>
</thead>
<tbody>
<tr>
<td>Normal repurchase</td>
<td>Arrival of repurchases date</td>
</tr>
<tr>
<td>Early repurchase</td>
<td>Finalization per trading</td>
</tr>
<tr>
<td></td>
<td>Refusal of exchange by a seller</td>
</tr>
<tr>
<td></td>
<td>Delisting of trading bonds</td>
</tr>
<tr>
<td></td>
<td>Earlier refund of principal and interest of trading bonds</td>
</tr>
<tr>
<td>Finalization of all agreements of non-repurchase (finalization as Single Agreement)</td>
<td>Settlement default by seller or buyer (including additional deposit)</td>
</tr>
<tr>
<td></td>
<td>Suspension or ban from trading with banks due to dishonor of bill or check/suspension of business/bankruptcy, dissolution, application of rehabilitation or commencing de-facto rehabilitation according to laws</td>
</tr>
</tbody>
</table>
**j. Trading/Settlement System**

**i. KRX REPO trading system (summary)**

<table>
<thead>
<tr>
<th>Item</th>
<th>System</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Type of REPO trading</strong></td>
<td>- Term REPO</td>
</tr>
<tr>
<td></td>
<td>- Classic REPO</td>
</tr>
<tr>
<td><strong>Market participant</strong></td>
<td>a security's member of the KRX (incl. bond specialist member)</td>
</tr>
<tr>
<td><strong>Counter trading party</strong></td>
<td>the KRX (anonymous trading)</td>
</tr>
<tr>
<td><strong>Eligible bonds for</strong></td>
<td>- government bonds (treasury bond, foreign exchange stabilization bond)</td>
</tr>
<tr>
<td></td>
<td>- specific laws bond (monetary stabilization bonds, KDIC bond)</td>
</tr>
<tr>
<td></td>
<td>- corporate bond (credit rating over Aaa)</td>
</tr>
<tr>
<td></td>
<td>* As of the trading day, total par value of redeemed bonds should be more than KRW 200 billion</td>
</tr>
<tr>
<td><strong>Trading unit</strong></td>
<td>KRWS billion (par value basis)</td>
</tr>
<tr>
<td><strong>Market value</strong></td>
<td>value calculated by the KRX based on evaluation values of 3 bond pricing agencies nominated by the head of FSC (simple arithmetic average price)</td>
</tr>
<tr>
<td><strong>Trading amount</strong></td>
<td>market value of trading bond[(haircut (2%) + 1)]</td>
</tr>
<tr>
<td><strong>repo rate</strong></td>
<td>Annual interest rate that the seller agreed to pay at the time of repurchase</td>
</tr>
<tr>
<td><strong>Repo terms &amp; repurchase date</strong></td>
<td>1 day (Overnight), 3-day, 7-day, 14-day, 21-day, 30-day, 60-day, 90-day (8 Repo terms)</td>
</tr>
<tr>
<td><strong>Trading (offering) hours</strong></td>
<td>09:00～15:00</td>
</tr>
<tr>
<td><strong>Trading method</strong></td>
<td>individual competition trading with multiple prices (price/time priority)</td>
</tr>
<tr>
<td></td>
<td>(no auction at single price)</td>
</tr>
<tr>
<td><strong>Realization of trading</strong></td>
<td>when there is a match between bid and asked</td>
</tr>
<tr>
<td><strong>kinds of offer</strong></td>
<td>- ask : only designated quotation is accepted</td>
</tr>
<tr>
<td></td>
<td>- bid : designated/non-designated are accepted</td>
</tr>
<tr>
<td></td>
<td>* designated : designation of a specific item</td>
</tr>
<tr>
<td></td>
<td>* non-designated : non-designation of a specific item</td>
</tr>
<tr>
<td><strong>Quotation unit</strong></td>
<td>0.01% re</td>
</tr>
<tr>
<td><strong>Price limit</strong></td>
<td>not applicable</td>
</tr>
<tr>
<td></td>
<td>* safety device for prevention of offer input by mistake (dealer's terminal/trading system)</td>
</tr>
</tbody>
</table>

**ii. KRX REPO settlement system (summary)**

**k. Accounting procedures of REPO System**

**i. REPO trading day**
REPO seller shall deliver bonds, fill trading amount received from buyer in the account of 'selling of REPO bonds' of short-term debt account, and re-assort collateral transferred to buyer from commodity (investment) bonds to 'REPO bonds'.

<table>
<thead>
<tr>
<th>item</th>
<th>system</th>
</tr>
</thead>
<tbody>
<tr>
<td>Repurchase agency</td>
<td>KRX</td>
</tr>
<tr>
<td>Settlement obligation</td>
<td>KRX</td>
</tr>
</tbody>
</table>
| Settlement method           | - cash payment: transfer in-between BOK reserves accounts (BoK-wire)  
                              - securities delivery: account transfer on depositor’s account (KSD Safe) |
| Time limit to settle        | - trading portion: by 16:00 of trading day  
                              - repurchase portion: by 16:00 of repurchase day  
                              - deposit money/dividend: by 16:00 of accrual day |
| Repurchase amount           | trading amount x (1/360 x contract term) |
| Return of dividend (incl. Transfer pay) | return of interest accrued from trading bond/maintenance margin bond |
| Marking to market           | - settlement method: evaluation of whole quantities considering all the contracts as single contract  
                              - Margin Call: when requested amount for settlement exceeds exemption rate |
| Type of deposit             | - haircut (initial deposit): the amount to be borne by a seller due to discount of market value of trading bonds at initial trading contract  
                              - additional deposit: deposit to be paid according to Margin Call of the KRX |
| Payment of deposit          | - type: cash/bonds  
                              - payment: report by 13:00/payment by 16:00 |
| Substitution of bonds       | - reason: request by seller (only for non-designated buying, it is allowed once per contract)  
                              - available period: next day of trading settlement “one day prior to repurchase  
                              - application/response: by 13:00/14:00  
                              - substitute bonds: bonds having more than evaluation value of trading bond before substitution (1 item among same category) |
| Exchange of bonds           | - reason: request by buyer due to dishonor of issuer of trading bonds  
                              - available period: next day of trading settlement “one day prior to repurchase day  
                              - application/response: by 13:00/14:00 (earlier repurchase in case of refusal)  
                              - exchangeable bonds: bonds having more than evaluation value of trading bond(1 item among same category) |
| Earlier repurchase          | - reason: settlement default of a party to contract, etc  
                              - settlement method: securities or cash |
REPO buyer shall receive bonds, fill money paid to seller in the account ‘buying of REPO bonds’ of short-term lending, and deal secured debt provided by seller with notes.

ii. Spot trading of REPO buying bonds

The seller, who sells secured bonds at spot market (spot selling) after buying REPO, shall be responsible to buy the bonds at spot market and to return them so that the restoration shall be recorded as ‘financial liability’.

He shall offset substitutive payment and financial liability when effecting substitutive payment of interest. When repurchasing bonds (spot), he shall debit financial liability, and shall compare preceding evaluation value with buying price of bonds to reflect profit & loss on ‘evaluated profit & loss of REPO trading’.

Following spot trading of buying bonds, the seller is liable to make voluntary payment of withholding tax for interest accrued during spot trading period, and thus, he shall enter the amount into ‘tax on interest income’ account and then debit at the time of paying it to tax office.

iii. Expiration of REPO

Accounting procedures at the time of Expiration of REPO trading are divided into 3 kinds as follows

<table>
<thead>
<tr>
<th>Kind of expiration of repo trading</th>
<th>Accounting procedures</th>
</tr>
</thead>
<tbody>
<tr>
<td>Normal expiration or early repurchase by refusal of exchange</td>
<td>Seller/buyer offset trading amount and repo buying/selling account and appropriate the refunded interest for payment/income commission account</td>
</tr>
<tr>
<td>Cash settlement or early repurchase by settlement default</td>
<td>Seller/buyer deal repo trading bond based on spot selling/buying</td>
</tr>
<tr>
<td>Early repurchase by early refund</td>
<td>Seller deals repo trading bond based on spot selling and buyer appropriates cash by early refund for debt account and offset in case of repurchase</td>
</tr>
</tbody>
</table>

D. FreeBond

1. FreeBond [launched in Apr. 2010]

a. Background

Similar to developed nations, the bond market in Korea has traditionally used telephone voice trading as negotiated sale method. With the advances in IT technology after the Asian financial crisis, instant messenger became an important trading method, particularly among young brokers, as the advantages of speed and storage function became widely known.

This new method sped up the way trading is executed and enabled market participants to overcome limitations, contributing to the development of the Korean bond market. However, private messenger undermined price discovery function, and when it crashed or slowed down, the bond market as a whole was paralyzed. In addition, there
were structural problems since it was difficult to adapt to the needs of market participants.

Against this backdrop, the government created a taskforce in March 2009 and announced the Reformation of Bond Trading Market that October, which aims to establish a specialized bond trading system. Based upon this measure, KOFIA established the online bond trading system, FreeBond.

Since the late 1990s, major developed nations have successfully introduced electronic bond trading systems using advances in IT technology. However, in the case of Korea, legal restrictions have hindered the introduction of ATS.

b. Main Contents

i. Definition and Composition of FreeBond

FreeBond, operated by KOFIA, enables financial investment firms and market participants to discover quotes and supports trade negotiations.

Participants refer to bond trading brokers, dealers, managers, and traders who apply to use the system and are approved by KOFIA pursuant to regulations on registration of financial investment companies.

In addition, KOFIA’s operation enables continuous communication with market participants, better reflecting the needs of participants.

![Operation of FreeBond](image)

1. Market participants discover bid/ask price on FreeBond and execute orders.
2. Quote information is transmitted to BQS.
3. The concentrated information is disclosed to the market through KOFIA’s Bond Information System (BIS) and information vendors.

As seen in the picture, FreeBond comprise of two main components: instant messenger and T-Board. Unlike private messenger, chat rooms are included in the system.

T-Board offers trading functions such as bid/ask prices discovery, orders, negotiation and confirmation, and analyses and reference. Instant messenger, a replacement of the current private messenger, provides functions specialized for bond trading including 1: N chatting and automatic storage of chatting records, on top of the general functions of private messenger.
ii. Characteristics of FreeBond

The major strengths of FreeBond are its specialization, security, and stability.

In terms of specialization, the system can only be used by bond trading professionals in line with the Regulation on Business and Operation of Financial Investment Companies. When a financial investment company applies to use the system and receive approval from KOFIA, bond traders from that company are able to access FreeBond.

Under this system, FreeBond can develop into a specialized system, unlike private messenger which anyone can access. In addition, T-Board enables market participants to find quotes in real-time, issues of interest, information on bond issuance, and it offers a bulletin board for trading.

Unlike private messenger, chat histories and quotes are encrypted, preventing hacking from occurring. Furthermore, its use is managed by KOFIA’s registration process, enhancing credibility in the system. To boost the stability of FreeBond, the system is backed up with double servers to prevent system failures from trade concentration, and it is managed around the clock.

iii. Expected effects

The success of FreeBond in the market with its wider use by market participants is expected to become a turning point in the advancement of the OTC bond market in Korea for the following reasons.

It will significantly improve the bond trading infrastructure. The formalized and safer FreeBond will not only boost the security of bond trading but it will also integrate the market which had been divided by different messenger groups.

Users can enjoy the ease and convenience of bond trading on FreeBond. Information asymmetry will be reduced, and price discovery and the search of trading counterparts will be easier.

FreeBond was designed by and for bond traders, which makes it especially “market friendly” and thus convenient for users. The system reflects all the requirements needed for trading, such as a variety of trading methods and analyses.

When FreeBond adds the settlement function and builds a global network with advanced bond trading system in the future, foreign investors will find it more convenient to participate in the Korean bond market and domestic financial institutions will be able to expand into overseas markets. This will eventually lead to the globalization of the Korean bond market.

In addition, the use of bond market information concentrated in the system will make it possible to calculate real-time bond indices and facilitate the development of new products, such as bond ETFs and interest derivatives.

While the bond and equity markets are the two major pillars supporting the Korea capital market, the bond market is still underdeveloped compared to the equity market. However, the launch of FreeBond will spur the advancement of the bond market, allowing it to serve its main role in the capital market.
E. Secondary Market Yields and Terms of Bond Issues

<table>
<thead>
<tr>
<th>Type of Bond</th>
<th>Instrument</th>
<th>Time to Maturity</th>
</tr>
</thead>
<tbody>
<tr>
<td>Government</td>
<td>KTB 3years</td>
<td>2 years 6 months – 3 years</td>
</tr>
<tr>
<td></td>
<td>KTB 5 years</td>
<td>4 years 6 months – 5 years</td>
</tr>
<tr>
<td></td>
<td>KTB 10 years</td>
<td>9 years – 10 years</td>
</tr>
<tr>
<td></td>
<td>KTB 20 years</td>
<td>10 years – 20 years</td>
</tr>
<tr>
<td></td>
<td>NHB1 5 years</td>
<td>4 years 6 months – 5 years 1 months</td>
</tr>
<tr>
<td>Municipal</td>
<td>Region1 5 years</td>
<td>4 years 6 months – 5 years 1 months</td>
</tr>
<tr>
<td>Special</td>
<td>Land 3 years</td>
<td>2 years 6 months – 3 years 1 months</td>
</tr>
<tr>
<td>MSB</td>
<td>MSB 91days</td>
<td>85 days – 91 days</td>
</tr>
<tr>
<td></td>
<td>MSB 364 days</td>
<td>10 months – 1 years</td>
</tr>
<tr>
<td></td>
<td>MSB 2 years</td>
<td>1 years – 2 years</td>
</tr>
<tr>
<td>Financial</td>
<td>KDB 1 years</td>
<td>10 months – 1 years 1 months</td>
</tr>
<tr>
<td>Corporate</td>
<td>Corp 3 years -non AA-</td>
<td>2 years 9 months – 3 years</td>
</tr>
</tbody>
</table>

F. Transparency in Bond Pricing

Transparency in Korea OTC Bond Market has been enhanced so dramatically due to the KOFIA’s role as an SRO.

1. The Role of KOFIA

KOFIA, based on FSCMA, FSC Regulations under FSCMA, and FSC Enforcement Rules under FSCMA, manages the information related to the transactions of bonds and their disclosure.

Through these actions, KOFIA enhances the price discovery function of the OTC bond market and increases price transparency. In addition, KOFIA is working toward developing a wide variety of policies in order to help the development of the Korean bond market.

2. Disclosure of Real-Time Bond Index

- Purpose: Yield real-time bond index based on KOFIA’s FreeBond which is used as a benchmark index for bond ETFs
- Expected effects: Understand real-time trends of the bond market
  - (Investor-side) Facilitate spread trading between spot bonds and bond ETFs, and enable investment in baby bonds
  - (Issuer-side) Reduce capital-raising costs due to the increased demand
  - (Financial firms-side) Use as a standard to evaluate investment performance and as a risk management index
Types of Real-Time Bond Index

<table>
<thead>
<tr>
<th>Index Name</th>
<th>Cycle</th>
<th>Source</th>
<th>First Disc.</th>
<th>Starting Index</th>
<th>Standard Point of Time</th>
</tr>
</thead>
<tbody>
<tr>
<td>MKFTB Index</td>
<td>30 Sec.</td>
<td>FreeBond</td>
<td>Jun. 09</td>
<td>100</td>
<td>'04. 6. 16</td>
</tr>
<tr>
<td>KTB Index</td>
<td>1 Min.</td>
<td>Collected by KRX, etc.</td>
<td>Jun. 09</td>
<td>10,000</td>
<td>'09. 6. 1</td>
</tr>
<tr>
<td>KEBI TB Index</td>
<td>5 Min.</td>
<td>FreeBond</td>
<td>Jul. 09</td>
<td>100</td>
<td>'09. 6. 30</td>
</tr>
<tr>
<td>MK MSB Index</td>
<td>1 Min.</td>
<td>FreeBond</td>
<td>Jan. 10</td>
<td>10,000</td>
<td>'10. 1. 1</td>
</tr>
<tr>
<td>MK MMI* Index</td>
<td>1 Min.</td>
<td>FreeBond</td>
<td>Jul. 10</td>
<td>10,000</td>
<td>'10. 6. 1</td>
</tr>
<tr>
<td>KOB Credit Index</td>
<td>1 Min.</td>
<td>FreeBond</td>
<td>Dec. 10</td>
<td>10,000</td>
<td>'10. 9. 1</td>
</tr>
</tbody>
</table>

[2010, Capital Market in Korea, p.156~159 and from KOFIA]

G. KOREA Bond Transaction Flow (For Foreign Investors)

Trade Date: T
Settlement Date* T+2
OTC Bond Transaction Flow for Foreign Investors

Description of Steps

1. Foreign Institutional Investor places order with International Broker
2. International Broker places order with Domestic Broker/Bank
3. Domestic Broker/Bank trades OTC with Counterparty (via phone or e.g. Bloomberg)
4. Domestic Broker/Bank and Counterparty report trade to KOFIA within 15 minutes of trade
5. Domestic Broker/Bank send trade confirmation to International Broker
6. Domestic Broker/Bank sends trade details to KSD
7. Foreign Institutional Investor receives trade confirmation
8. Foreign Institutional Investor instructs Global Custodian on securities settlement details, and FX/funding
9. Global Custodian instructs Domestic Custodian on (a) securities settlement details, and (b) FX/funding requirements
10. KSD sends Preliminary Settlement Data to Domestic Custodian, via SAFE
11. Domestic Custodian affirms settlement details
12. KSD sends affirmation status to Domestic Broker/Bank
13. Domestic Custodian reports transaction status update to Global Custodian
14. Domestic Custodian sends FX confirmation to Global Custodian
15. Domestic Custodian confirms BOK account
16. Upon transfer of cash, BOK sends settlement confirmation to Domestic Custodian
17. Upon transfer of securities, KSD sends settlement confirmation to Domestic Custodian
18. Domestic Custodian sends settlement confirmation to Global Custodian
19. Global Custodian funds account with Domestic Custodian, or into FCY nostro (before end of day)
20. Global Custodian sends settlement confirmation to Foreign Institutional Investor
21. Domestic Custodian sends securities statement to Global Custodian
22. Domestic Custodian sends cash credit/debit confirmation in cash statement to Global Custodian
23. Global Custodian sends credit/debit confirmation in cash statement to Foreign Institutional Investor

OTC Bond Transaction Flow for Foreign Investors

Additional Comments

• Bond transactions in the OTC market have been subject to mandatory book-entry settlement (at KSD) since 1995. Market participants pre-match through KSD’s InSet system
• OTC market participants have option to negotiate settlement date between T+1 and T+30. Assumption of T+2 of more representative for FII trades
• 4 – Trade reporting by all trading counterparties to KOFIA within 15 mins
• 6 – Here, trading counterparties actually send trade details into KSD
• 10 – KSD sends future settlement details to Domestic Custodian, and
• 11 – Domestic Custodian only needs to affirm/confir details, based on client instructions received
• 12 – Subsequently, KSD send affirmation status back to trading counterparty
• 16,17 – Sequence set based on typical sequence in other markets, where CSD sends request for funding, cash then settles first, upon which securities side settles; whether sequence of actual sending confirmations is as expected, would need to be confirmed

OTC Bond Transaction Flow for Foreign Investors

Outstanding Questions

• Need to confirm assumption of T+2 settlement cycle; on exchange trades have max. T+1, KOFIA mentions T+1 as standard but also refers to T+1 to T+30
● Need to confirm: pre-matching at KSD - InSet system as mentioned in market guides?
● Need to confirm whether brokers and banks participate in OTC; most market guides make reference to brokers only, even for OTC trades
● On website, KSD mentioned clearing/netting function; is this applicable to OTC bond segment as well?
● Need to establish functionality of SAFE (front-end or feature rich)?

[ADB Consultant: MS]
IV. Possible item of impediments / restrictions for the realization of a cross-border inter-regional market

A. Taxation

1. Withholding Tax on Interest Income

Korea withholds tax on interest income as a rule, with different rates applied depending on the investor's residency. For residents, a 15% withholding tax is levied on interest income from bonds. For nonresidents, a 10%–15% tax is levied for residents of countries with a tax treaty and a 25% tax is levied for residents of countries without a tax treaty.

Tax withholding on interest income affects the after-tax rate of return.

Even if the host country does not withhold tax on interest income, foreign investors must pay tax in their home country. In addition, if the host country does levy withholding tax and if it exceeds the tax amount that foreigners have to pay to their home country, they can receive reimbursement for the difference.

Accordingly, tax withholding does not necessarily lead to a lower after-tax rate of return. Nonetheless, the inconvenience arising from processing tax returns and adjusting tax based on the holding period make bond trading complicated.

Thus, international bond investors, including bond funds that invest in bonds in different countries, tend to avoid countries where withholding tax is imposed.

For this reason, some countries, including developed countries, seek bond investments from foreigners by abolishing withholding tax or exempting nonresidents from withholding tax on interest income.

The Working Group 2 organized under the Asian Bond Market Initiative (ABMI) recommended abolishing or lowering withholding tax on interest income for foreign investors to attract increased foreign investment in domestic bonds. Following this ABMI recommendation, Thailand and Malaysia abolished their respective withholding taxes on interest income for foreign investors.

In January 2009, in the middle of the currency crisis caused by the global financial crisis, the Korean government decided to exempt nonresidents from withholding tax on interest income from all government bonds and MSBs.

This policy was intended to encourage foreign investment in domestic bonds, however, its effect on foreign investment has yet to be determined.

The MOSF has supervisory power over tax policy and administration.

Within this ministry, the National Tax Service is responsible for enforcing tax laws and regulations. In Korea, taxes are levied at both the national and local levels. National taxes consist of internal taxes, customs duties and surtaxes. Internal taxes are further subdivided into direct and indirect taxes.
Local municipalities administer local taxes and such taxes include general and specific taxes. Korean securities-related taxes consist of securities transaction taxes and income taxes.

The securities transaction tax is considered an indirect tax, whereas the securities income tax is part of the direct tax category.

[Bond Market in Japan and Korea]

B. Disclosure & Investor Protection Rules for Issuers

1. Overview

Article 1 of the 2009 Financial Investment Services and Capital Markets Act (FSCMA) stipulates that “the purpose of the Act is to contribute to the development of the national economy by facilitating financial innovation and fair competition in the capital market, protecting investors, enhancing the development of the financial investment business and heightening the fairness, reliability and efficiency of the capital market.”

When the financial assets of an ordinary investor are unfairly treated by a financial investment business entity or such an entity recommends financial investment instruments by providing misleading or false information that is not adequate for an ordinary investor considering their investment purpose, the investor will lose confidence in the capital market.

As such, investor protection is crucial not only to protect the rights of investors as the consumers of the market, but also to promote the sound development of the capital market.

Since many of the articles in FSCMA include investor protection, it is hard to detail all the relevant provisions governing investor protection; however, this chapter will discuss the major provisions of FSCMA relating to investor protection.

2. Disclosure

The term disclosure refers to the provision of information to the general public so that anyone may have access to such information. Unlike institutional investors or other professional investors, ordinary investors are highly likely to be excluded from material information that may have a significant impact on the value of stocks and other financial investment vehicles.

Therefore, such material information shall be disclosed to ensure fair trading in the financial market. FSCMA stipulates a series of provisions concerning the matter. The provisions of disclosure are related to investor protection in that the purpose of these provisions is to prevent damages being inflicted upon ordinary investors due to information asymmetry.

Investors shall make reasonable and informed decisions based on such publicly disclosed information.

Information on financial investment instruments and financial investment business entities is disclosed on the KOFIA website (http://www.kofia.or.kr). KOFIA’s electronic disclosure system posts information on financial investment instruments, financial investment business entities, and professional investors.

Matters that a securities company must disclose include commission rates, management disclosure, ad hoc disclosure and net capital ratio.

Commission rates are provided by the amount of trading and the methods of transaction (online or offline).

Management disclosure includes information on any cases of litigation or restrictions relevant to the securities company.

The disclosed information can be utilized to assess the compliance of the company to the internal controlling policies for investor protection.

A collective investment business discloses information on asset management companies and funds. An asset management company provides periodic disclosures including closing accounts reports, periodic reports, and periodic management disclosure as well ad hoc disclosures.

A collective asset management entity shall submit an asset management report of funds at least once every three months, including the operating performance of funds, total amount of asset and liabilities of funds, the assessed value of each type of asset that belongs to the funds, the total number of stocks traded, total trading amount, turnover rate during the pertinent management period, matters concerning professional investment managers, and the fees for each investment broker.

Ad hoc disclosure for a fund and an asset management company includes the details described below. An asset management company shall immediately disclose the occurrence of any massive financial scandal or non-performing claims.

Such information is material to assess the soundness of the company since any massive financial scandal or non-performing claim represents inadequate risk management or internal control systems within the company.

Meanwhile, the ad hoc disclosure of funds provides information such as changes in fund managers, decisions on deferment or resumption of redemption and the reasons thereof, details of resolutions of the general meeting of collective investors, and details of a change in the base price.

The KOFIA website also posts information on professional managers including securities investment advisors, derivatives investment advisors, and fund investment advisors with their company names and business areas.

4. Disclosure in the Secondary Market

A listed company shall make periodic disclosures as well as ad hoc disclosures when it is deemed necessary. The information on a listed company is easily accessible on the website of KRX.

a. Periodic disclosure
Periodic disclosure includes annual, semi-annual and quarterly reports. Anyone can have access to the information via the electronic disclosure system on the websites of KRX or FSS.

A listed corporation shall submit an annual report to FSC and KRX within ninety days of the end of the business year.

An annual report shall include an overview of the company, the trade name, details of its business, the remuneration of executives, matters concerning finance (financial statements), the accounting auditor’s audit opinion, the organization of the company including the board of directors, shareholders, executives and employees, details of transactions with major shareholders, executives or employees of the company, and matters concerning investor protection.

Such information is material to the selling or purchasing of stocks of the company and assessing the value of securities. Details of what is included in an annual report are listed in Table 16-2.

A semi-annual report is a six-monthly business report and a quarterly report is a three-monthly report calculated from the commencement date of the pertinent business year. A listed company shall submit the reports to FSC and KRX within 45 days of the closing of each term.

If any of the following events that may have a significant impact on the management of a company occur, the company shall submit a report on the details of the events to FSC by the following day from when such events occurred.

The events include: a bill or check issued by the corporation is returned or its check account transactions in a bank are suspended or banned; its business activities are completely or partially suspended; and there is an application filed for commencement of proceedings for rehabilitation under the Debtor Rehabilitation and Bankruptcy Act.

A person who has acquired or disposed of securities issued by a corporation has the right to make a claim for damages caused by a false description or an omission of a material fact in a business report.

The claim for damages can be made against the directors of the corporation, the person in charge of the business report, or the auditor.

In addition, when a business report has not been submitted, or a false description or an omission of a material fact exists, the FSC may suspend any securities issuance by the company for up to one year, file criminal complaints, or recommend the dismissal of executives.

b. AD HOC disclosure

Ad hoc disclosure refers to reports that listed companies shall prepare without delay in order to immediately notify KRX of any material changes related to their business operations.

KRX provides the disclosure requirements for the Stock Exchange and KOSDAQ respectively. Since the ad hoc disclosure typically contains the material information that may have a significant impact on the value of the company and the stocks, anyone may access such information through the KRX website. Although the ad hoc
disclosure includes a massive amount of information, it can be classified into three categories and KRX shall be notified of the following information by the following day from which such events have occurred.

First, matters that may have an impact on the operation or production of a listed company, such as a full or partial suspension of business operations that takes up 10% or more of the sales volume or any administrative measures thereof; the suspension of transactions that makes up 10% or more of sales; or the conclusion of contracts for product supply or sales.

Second, events that may change the financial structure of a listed company, for example the increase and reduction of capital, retirement of stocks, disposal of treasury stocks and stock splits that may have an impact on securities issued by a listed company; new facility investments that take up 10% or more of the equity that may have an impact on production; short-term borrowings that take up 10% or more of the equity that could have an impact on the credit or liability of the company; natural disasters that could have an impact on the profit and loss of a listed company by 5% or more at the year’s end; and any decisions made on stock dividends.

Third, matters that may have an impact on the management of a listed company such as any changes in corporate governance due to changes in the largest shareholders; or litigation related to the company is brought to court, or a judgment on litigation is made.

Article 392 of FSCMA prescribes that, in order to secure the effectiveness of disclosure, banks shall notify KRX of material information that is likely to affect investors’ decision without delay, for example, where any issued bill or check defaults; or where any current account transaction with the bank is suspended or prohibited.

c. Fair disclosure

Korea’s securities market introduced the fair disclosure rule in November 2002.

The rule requires that if a company discloses information to selective investors and it is deliberate, the company shall also provide such information to ordinary investors at the same time.

When the disclosure is accidental, the company shall disclose such information to ordinary investors on the same day without delay.

The purpose of fair disclosure is to prevent insider trading and information asymmetry, and to allow more investors to receive the material information in a timely manner.

The rule also aims to make the market fairer and more transparent and thereby enhances investor confidence. Fair disclosure is to supplement the ad hoc disclosure system and is implemented by KRX, a self-regulatory exchange.

Detailed disclosure information is accessible on the website of the KRX website.

The information released in fair disclosure is different from that of periodic or ad hoc disclosures in that it pertains to expected data, such as business projection, management projection, projections of sales, operating income or loss, net income or loss before tax from continuing operations and net income or loss.
Such information is material since it has a direct impact on stock prices, and if it were selectively disclosed only to institutional investors or analysts, individual investors would be disadvantaged when making investment decisions.

In this regard, fair disclosure is a regulation to protect ordinary investors.

[2010, Capital Market in Korea, p.281–287]

C. Restriction of Investors (qualified institutional investors, private placement)

FSCMA in Chapter II stipulates the legal provisions on the restriction of investors. The legal provisions are as follows:

Section 1. Requirements and Procedure for Authorization

Article 11 (Prohibition against Business Activities without Authorization)
No one may engage in a financial investment business (excluding an investment advisory business and a discretionary investment business; hereafter the same shall apply in this Section) without authorization (including authorization for changes) for the financial investment business under this Act.

Article 12 (Authorization for Financial Investment Business)

(1) An entity that wishes to engage in a financial investment business shall select all or part of its business units (hereafter referred to as “authorized business units”), as defined by Presidential Decree, by specifying the constituents enumerated in following subparagraphs, and shall obtain authorization for a single financial investment business from the Financial Services Commission:

<Amended by Act No. 8863, Feb. 29, 2008>

1. The type of financial investment business (referring to investment trading business, investment brokerage business, collective investment business, and trust business, and also including an underwriting business in the category of investment trading business);

2. The rage (referring to the type of collective investment scheme under Article 229 in the case of a collective investment business, or referring to the trust property under subparagraphs of Article 103 (1) in the case of a trust business) of financial investment instruments (referring to securities, exchange-traded derivatives, and over-the-counter derivatives, including state bonds, corporate bonds, and other instruments specified by Presidential Decree in the category of securities, and also including derivatives based on underlying assets of stocks and other instruments as specified by Presidential Decree in the category of derivative); and

3. The class of investors (referring to the classification of professional investors and ordinary investor; hereafter the same shall apply).

(2) An entity that wishes to obtain authorization for a financial investment business under paragraph (1) shall satisfy all of the following requirements:
1. An entity shall fall under any of the following items: Provided, That an investment brokerage business entity willing to run an electronic securities brokerage business under Article 78 shall be a stock company under the Commercial Act and a member of the Korea Exchange:

   a. A stock company under the Commercial Act or one of the financial institutions specified by Presidential Decree; and
   b. A foreign financial investment business entity (referring to a person who runs a business corresponding to a financial investment business in a foreign country in accordance with the Acts and subordinate statutes of the foreign country), who has installed a branch office or any other business consistent with the business it currently runs in the foreign country;

2. An entity shall have its own equity capital equivalent to or more than the amount set by Presidential Decree, which shall be at least 500 million won for each authorized business unit;

3. An entity’s business plan shall be feasible and sound;

4. An entity shall be equipped with human resources, an electronic computer system, and other physical facilities adequate for protecting investors and running a financial investment business in which it intends to engage;

5. No executive may fall under any subparagraph of Article 24;

6. The major shareholders or a foreign financial investment business entity shall meet all of the requirements set forth under the following categories:

   a. In the case subparagraph 1 (a), its largest shareholder (including shareholders who are specially related persons of the largest shareholder; and where the largest shareholder is a corporation, persons who exercise de facto control over matters material to the management of the corporation, as specified further by Presidential Decree, shall be included herein) shall have adequate investing capabilities, good financial standing and social credibility; and
   b. In the case of subparagraph 1 (b), the foreign financial investment business entity shall have adequate investing capabilities, good financial standing and social credibility; and

7. An entity shall have a system for preventing conflicts of interest between the financial investment business entity and investors, as well as between a specific investor and other investors.

(3) Further details necessary for fulfilling requirements for authorization under paragraph (2) shall be prescribed by Presidential Decree.

[FSCMA, Chapter II]
D. Registration Requirement for Foreign Investors

As the aforementioned in the section 2.04, the Foreign investors are required to register to FSS for participating in bond market. However, there is exemption from registration. That is as follows;

1. Exemption from registration

Foreign nationals, foreign-incorporated entities, or local branches of a foreign corporation engaging in business activities in Korea that qualify for “foreigner under national treatment” status, shall be exempt from registration upon submitting documents verifying their status.

Registration will also be exempted in the case of acquiring stocks on the OTC market for the purpose of “direct investment” as well as disposing of direct investments, but the details of the relevant transactions must be reported promptly to the FSS.

Exemption from registration will also apply to cases where government bonds and market stabilization bonds are acquired and sold using “omnibus accounts” under the name of the International Central Securities Depository (ICSD) through an ICSD account.

[2010, Capital Market in Korea, p.235~236]

E. Reporting requirements (non-resident trade report, foreign currency denominated instruments etc.)

According to the Detailed Rules of the Regulations on Financial Investment Business, foreign investors or corporations and institutions related with securities trading for foreigners have an obligation to report.

[2010, Capital Market in Korea, p.253]

F. Non-resident requirements

Based on Subparagraph 2 of Paragraph 1 of Article 1 of ITA, a person who holds an address in Korea or has held a temporary domicile in Korea for one or more years is referred to as a resident. Any foreign investor not meeting that definition is defined as a non-resident.

Therefore, according to this definition, a person who does not have an address or temporary domicile in Korea for one or more year is defined as a non-resident.

The address is this context is determined by the objective facts of a living relationship, such as the existence of a family living together in Korea and of property located in Korea.

The term domicile in this context means the place where a person has resided for a long time, besides their address, and in which there is no general living relationship, according to Paragraph 1 and 2 of Article 1 of EDITA.
G. Restrictions on OTC Transactions by Non-residents

The KOFIA prohibits OTC transactions of listed securities between nonresidents. Nonresidential investors can make transactions of listed securities through the KRX by making orders to the securities companies that are members of the KRX.

If a nonresident investor wants to trade listed bonds over-the-counter, the trade should be conducted through the intermediation of Korean securities companies.

This regulation applies to almost all bonds issued in Korea since most publicly-issued domestic bonds are listed on the exchange market for tax purposes.

In many countries, bonds are generally traded in the OTC market. When foreign financial companies wish to trade Korean bonds owned by them or their clients, they naturally try to find counterparties in the OTC market with whom terms can be negotiated.

If a transaction in the OTC market has to be made through a Korean securities firm, it is possible that foreign investors will have to pay additional costs or lose the possibility of finding an advantageous trading opportunity.

Such possibilities may keep foreign financial companies from investing in Korean bonds or recommending Korean bonds to their customers.

[Bond Market in Japan and Korea]

H. Credit Rating System and its relation to Regulations

[Overview of Credit Rating Framework and Governing Regulations]

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<th>Description</th>
</tr>
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<tbody>
<tr>
<td>Introduction</td>
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<td>- Credit rating for commercial papers and corporate bonds began in 1985 and 1986 respectively</td>
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<td>- Legal requirement for receiving two or more credit ratings for issuance of securities imposed in 1994</td>
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<td>Perspective on Credit Rating Agencies</td>
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<td>- Domestic regulations attach significance to the role of CRAs as offering of information.</td>
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<td>CRAs are subject to civil liability.</td>
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<td>- Article 750 of the Civil Act (Definition of Torts)</td>
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<td>- Articles 125, 127 and 162 of the Capital Market Consolidation Act</td>
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<tr>
<td>- Article 40 of the Use and Protection of Credit Information Act</td>
</tr>
</tbody>
</table>
| * Criminal liability stipulated under Article 50 of the Use and Protection
I. Prohibition on the Use of Omnibus Accounts for Settlement of Securities Transactions

Foreigners who invest in Korean domestic bonds normally depend on local or global custodians to settle their transactions and keep the bonds they have acquired. In making settlement for securities transactions, custodians usually use omnibus accounts through which they consolidate all of their clients' transactions into a single account and make payments and deliveries using that account.

The foreign exchange regulation in Korea, however, requires that payments to settle securities transactions by foreigners must be processed through the individual account of each foreign investor. Since omnibus accounts for payments are not allowed for foreign investors, the custodian banks in charge of settling the bond transactions of foreign investors have to make payments through the individual account of each foreign investor. This leads to added costs and inconvenience.

Despite the higher costs and added inconvenience, foreign investors can still get settlement service for their transactions of Korean domestic bonds from local or global custodians.

The real problem caused by the prohibition on the use of omnibus accounts lies with the fact that ICSDs, such as Euroclear and ClearStream, which usually provide settlement service for local bonds as well as international bonds, do not provide settlement service for local bonds of the countries where omnibus accounts are not allowed. Since ICSDs provide settlement services as well as depository services for bonds in many countries, international bond investors tend to use ICSDs to settle their international bond transactions.

It is likely that these investors stay away from countries where ICSDs do not provide settlement services since investing in such countries requires the hiring of an additional custodian bank instead of relying upon the convenience of a single custodian taking care of all of their international transactions.

Prior to 2007, ICSDs did not provide settlement service for Korean bonds because the use of omnibus accounts by foreign investors was prohibited. As a consequence, it is plausible that Korea may have been losing potential foreign investments from those who would have invested in Korean bonds had they been able to settle their transactions through ICSDs.

To address this shortcoming, the Korean government allowed ICSDs to use omnibus accounts to settle transactions of domestic bonds by foreign investors. The revised regulation stipulates that Clearstream and Euroclear can provide settlement services for the country's government bonds and MSBs through their omnibus accounts set up at the Korea Securities Depository (KSD).

Allowing omnibus accounts not only provides foreign investors with the benefit of lower cost and convenience in settlement, but also enables them to avoid significant
institutional impediments. First, foreign investors do not have to register with the Financial Supervisory Service and get an investment registration certificate in advance if they settle their transactions of Korean domestic bonds through an ICSD. They can simply hold Korean domestic bonds at the representative omnibus account under the title of an ICSD.

In addition, the new regulation enables OTC transactions of Korean domestic bonds when these are deposited in and settled through the omnibus accounts of an ICSD. As a result, a foreign investor may now sell Korean government bonds to another foreign investor through a direct OTC transaction when both parties engage in the transaction via financial institutions that have settlement accounts at an ICSD.

Allowing ICSDs to make settlements using a representative omnibus account, however, may cause some problems in relation to the income tax exemption for foreigners. As was mentioned earlier, the Korean government decided to give foreign investors exemption from withholding tax on interest income from government bonds and MSBs in January 2009.

Since foreign investors no longer need an investment registration certificate if they settle their transactions through the omnibus account of an ICSD, a domestic investor can easily disguise himself as a foreign investor by making settlement through an ICSD to gain a tax exemption on interest income.

In order to address the potential for tax evasion, the Korean government has introduced the Qualified Financial Intermediary (QFI) system.

Under this system, the settling members of ICSDs that acquire QFI status are allowed to make settlement of Korean domestic bond transactions for their customers through the omnibus accounts of ICSDs.

In order to qualify as a QFI, a financial institution is required to assess customer adequacy of foreign investors for tax exemption and keep track of the bond transactions and holding records of foreign investors so that they can report to Korea’s National Tax Service as necessary.

In spite of the clear benefits, the use of omnibus accounts is an exception rather than a rule. It is only the ICSDs that are allowed to use omnibus accounts.

Therefore, foreign investors who do not settle their domestic bond transactions through ICSDs are still subject to restrictions such as registration requirements, prohibition of direct OTC transactions between foreign investors, and prohibition on the use of omnibus accounts.

[Bond Market in Japan and Korea]

J. Availability of Information in English

As Korean is used as the working language in domestic bond markets, there is a language barrier for foreign investors and traders. In addition, the supply of English-language documents on investment analyses of domestic bond markets for foreign investors is insufficient.

[Bond Market in Japan and Korea]
K. Restrictions in Accounting Standard

FSCMA in Chapter III stipulates the legal provisions on Accounting. The legal provisions are as follows;

Article 32 (Accounting)

Each financial investment business entity shall comply with the following in accounting: <Amended by Act No. 8863, Feb. 29, 2008; Act No. 9407, Feb. 3, 2009>

The fiscal year shall be the term specified by Ordinance of the Prime Minister for each type of financial investment business;

The propriety property of each financial investment business entity, the trust property, and other property of investors specified by Ordinance of the Prime Minister shall be clearly separated in accounting; and

A financial investment business entity shall follow the general accounting principles of financial investment and standards for accounting under Article 13 of the Act on External Audit of Stock Companies determined by the Financial Services Commission, and provided by public notice, after going through a resolution of the Securities and Futures Commission.

Matters not provided for in paragraph (1) in relation to the accounting of the proprietary property of a financial investment business entity, types of account titles and order of arrangement, and other necessary matters shall be determined by the Financial Services Commission, and provided by public notice. <Amended by Act No. 8863, Feb. 29, 2008>

[L. Limited Opportunities to Utilize Bond Holdings]

Bond investors in general make active use of their bond holdings to enhance returns from their investment. For instance, bonds can be used as collateral to cover counterparty risk in OTC derivative transactions.

They can be utilized for lending and borrowing transactions, as well as repo transactions. In Korea, however, such opportunities are quite limited because neither the inter-institution repo trading nor the lending and borrowing transactions of bonds are active. Moreover, there exists a limitation on the maximum amount of Korean won that foreigners can borrow through repo transactions or lending and borrowing transactions.

These restrictions deprive foreigners of the opportunity to enhance the returns from their investment in Korean bonds, rendering investment in Korean bonds less attractive.

[M. Degree of Lack of Liquidity in the Secondary Market]
Liquidity in the secondary market for bonds is relatively low in Korea, making investors in domestic bonds exposed to a higher liquidity risk. Various factors are responsible for the relatively low liquidity.

First, most large domestic investors, including pension funds and insurance companies, tend to be buy-and-hold investors.

Second, the market-making ability of bond dealers is quite limited. Finally, based on market convention, the minimum trading unit in the OTC market is set at KRD10 billion, which is extraordinarily high compared to minimums in other countries.

[Bond Market in Japan and Korea]
V. High level description of the securities settlement system

A. Existence of uniform legal framework for (all / certain) types of securities

In Korea, there is Financial Investment Services and Capital Market Act (FSCMA) on the securities. The purpose of this Act is to contribute to the development of the national capital market, protecting investors, rearing the development of the financial investment business, and heightening the fairness, reliability, and efficiency of the capital market.

In this Act, the bonds are defined such as “debt securities” including local government bonds, special bonds, corporate bonds, corporate commercial papers, and other similar instruments.

B. Dematerialization / Immobilization vs. Physical securities

1. Dematerialized securities

Securities which are not issued in paper form and which ownership is held and transferable by book-entry in a ledger maintained by a CSD or account management institution.

2. Immobilized securities

Physical securities and non-certificated securities held and transferred by book-entry in a ledger maintained by a CSD or account management institution.

C. Legal ownership structure of dematerialized / immobilized securities

1. Dematerialized securities

The ownership of dematerialized securities is held individually through an account opened at the CSD or account management institution.

2. Immobilized securities

The method of holding the securities is same as dematerialized securities, but the ownership is not held individually, and is held collectively with a share in the joint ownership.

That is, ownership of deposited securities is held in the form of indirect possession through the central depository (direct possessor) and account management institution (indirect possessor).

D. Legal ownership transfer mechanism

1. Dematerialized securities

Delivered by book-entry across the accounts of the transferor and transferee opened at the CSD or account management institution
2. Immobilized securities

Same as dematerialized securities

* Note 1) The account structure of dematerialized and immobilized securities are explained based on the two-tier account structure.

2) The form of ownership for dematerialized securities cites the common view in the academia of Japan, and the form of ownership for immobilized securities is explained in terms of the Korean deposit and settlement system.

E. Existence of CSD and Book entry system for debt instruments

Securities deposit is a process through which rights over securities are transferred, altered, and nullified by book-entry without the actual movement of physical certificates. To benefit from the securities deposit system, participants such as brokers or institutional investors have to open participant accounts at the Central Securities Depositories (CSDs) and deposit their securities at the CSDs. In Korea, the Korea Securities Depository (KSD) is the single CSD and provides securities deposit service.

1. How does it Work?

The securities deposit system consists of KSD as an operator, participants and their customers as users, and deposit-eligible securities as objects. Securities holdings of participants are held in custody on a fungible basis at KSD and are settled on a book-entry basis by recording debit/credit on the account book, a legal ledger kept by KSD and its participants.

2. What are the Benefits?

a. safe and Convenient Securities Transaction

When participants and their customers trade securities, they don’t have to return their securities because KSD settles transactions by book-entry without the physical movement of securities. Thanks to the securities deposit system provided by KSD, transactions of deposited securities are conducted in a safe and convenient way without the risk of loss and theft of physical securities and the burden of incidental expense.

b. Corporate Action Service

The participants and their customers who have deposited their securities at KSD don’t have to withdraw securities in order to exercise their rights against issuing companies. KSD provides corporate action services in relation with the deposited securities on behalf of them including dividends and principal & interest. Therefore, KSD participants and their customers can enjoy expedient and convenient corporate action services.

c. Comprehensive Securities Information Service

KSD participants and their customers can benefit from the comprehensive securities information service provided by KSD. KSD collects and manages all the information related to deposit-eligible securities. Issuance information, deposit information, lost and stolen securities, and corporate action information, to name a few.
3. The settlement system in Korea has developed in 3 major directions.

a. The ‘Book entry system’

The ‘book entry system’ has been introduced as a protection measure against ‘paperwork crisis’, which refers to situations where the transfer of real securities or administration of reading slips arising from the sudden increase of securities trading cannot be dealt with.

After the emergence of paperwork crisis, countries from around the world have tried to reduce inconveniences and risks that follow the transfer of real securities by depositing mainly securities at the Central Securities Depository.

Therefore, this system uses electronic methods for the transfer of securities by immobilizing securities or disposing of physical securities.

b. The ‘multilateral net settlement system’

The ‘multilateral net settlement system’ has been introduced to reduce settlement charges and operational expenses. Compared to the ‘gross base settlement system’, this system reduces settlement funds and securities by approximately 90%.

It also reduces an astonishing number of processed cases for settlement and has therefore established itself as a modern day settlement system. For multilateral netting, trading data must be received and confirmed, and the deposit must be collected in order to guarantee settlement performance.

After multilateral netting, instructions for the book entry exchange of securities and book entry transfers for charges are made to both the depositing organization and bank. Such duties have been carried out mainly by the clearing house.

c. The ‘central counterparty (CCP) system’

The ‘central counterparty (CCP) system’ has been introduced to eliminate various legal risks. The CCP refers to intervening between parties that trade in one or more financial markets. Through innovations, open offers, and debt assumption, etc, CCP becomes buyer for all sellers and seller for all buyers.

Although the multilateral netting system greatly reduces settlement charges for market participants, if netting controls do not receive legal approval, netting settlement must be restored to the gross base settlement.

This incurs high liquidity and system risk in the market. Since problems for the legal effectiveness of multilateral netting arise from the lack of mutuality (1:1), each country tries to satisfy the requirements by initiating the CCP system to convert the transaction contract structure from a multilateral to 1:1 composition (Korea’s civil law also stipulates an appropriation of 1:1). Since the CCP simultaneously possesses the status of a contracting party, performance of transaction contracts, that is, all authority and responsibilities related to settlement clearing, reverts to the CCP.

The traditional meaning (in a broad sense) of a settlement system is differentiated today into ‘clearing system’ and ‘settlement system in a narrow sense’. The clearing
The system has merged the aforementioned second and third processes and has developed into a clearing institution (clearing house) with the CCP being the core concept.

The settlement system in a narrow sense is specialized by the Central Securities Depository, which is in charge of book entry exchanges of securities, and the payment settlement system (central and commercial banks), which is responsible for the transfer of charges.

Korea’s securities market has also developed by following this path. The clearing house (CCP) is operated in-house by the KRX, the book entry exchanges of securities is managed by the Korea Securities Depository, and the transfer of charges is handled by the Bank of Korea and commercial banks.

The Capital Market and Financial Investment Service Act provides a clear definition of the role of the clearing house and settlement organization in the securities market. Under the law, Korea Exchange should play the role of a clearing house, and Korea Securities Depository should serve as the settlement organization.

[www.krx.co.kr>rules&reulations>settlement overview]

F. Existence of DVP and RTGS mechanism

1. Delivery versus Payment

The settlement of bond purchases in the OTC market is possible from the current business day, to the following business day (T+1), through to the 30th business day (T+30) under the agreement between the parties in the transaction. T+1 is most common. However, repo, retail bonds, and MMF included bond transaction may be settled the same day.

Settlement of bonds in the OTC market is done by the DVP of securities and payment, which aims to simultaneously deliver the bonds and settle the payment in order to increase the safety and efficiency of bond trading.

Introduced in November 1999, DVP involves simultaneous bond settlement, where remittance between the customer’s account using the KSD’s SAFE system and settlement using a BOK-Wire account takes place at the same time. In order words, KSD sends the securities for sale to the purchasing institution’s escrow account, while the purchasing institution orders BOK to remit the settlement to the selling institution through their current account at the KSD.

The value of DVP in OTC trading of bonds in the first half of 2009 was KRW 1,099tn, marking an approximately 42% increase year-on-year. By type, government bonds accounted for the largest portion of bonds remitted at KRW 787tn (71.6% - including monetary stabilization bonds); financial bonds KRW 173tn (15.7%). Other bonds, including special bonds and corporate bonds, totaled KRW 139tn (12.7%).

[2010, Capital Market in Korea, p. 154]

G. Existence of post-trade matching mechanism

1. Reporting Duties of the Dealers
In order to facilitate price discovery and enhance post-trading transparency in the OTC market, the Korean government introduced the Bond Trade Report and Information System in 2000. Under this system, licensed bond dealers are required to report the specifics of each transaction to the Korea Financial Investment Association (KOFIA) through computer terminals within 15 minutes after the transaction has been conducted.

KOFIA is then required to post the trading details. Since the regulation allows exceptions to the 15-minute reporting requirement, however, a number of transactions in the OTC market are reported after 3:00 PM even if the transactions were conducted between 9:00 AM and 3:00 PM.

2. Collection and Reporting of the Transactions Data

The transactions data, including the price and the trading volume in the KRX government bond market, are available on a real time basis to eligible participants. For transactions in the OTC market, KOFIA collects trading data reported by licensed bond dealers and reports them on the website on a real time basis. The trading data are also provided to various data vendors.

[Bond market in Japan and Korea]

H. Existence of execution matching mechanism

Clearing is the process of transmitting, reconciling and, in some cases, confirming payment orders or securities transfer instructions prior to settlement, possibly including the netting of instructions and the establishment of final positions for settlement.

After netting, participants of securities market can have a final position, securities delivery or cash payment.

Trade Reporting is the first step for settlement. An Exchange and trading parties in the OTC market have to report their trades to the Clearing House (CCP) or the CSD (KSD).

Trade reporting is a very important process in an organized market because, after receiving trade reporting, a Clearing House interposes itself as a counterparty and guarantees the completion of the whole trades.

The next process is trade comparison(matching). The comparison is the process of comparing the trade details to ensure that trading parties agree with respect to the terms of the transaction.

Trade comparison is acted by clearing houses for Exchange Markets and by settlement organizations for OTC Markets.

The next step of clearing is netting! Netting is an agreed offsetting of position or obligation by trading partners or participants. Netting is the process of reducing multiple credit/account obligations among multiple traders to several credit/account obligations.

Netting is classified into bilateral netting and multilateral netting by the numbers of trade parties. Bilateral netting is that both parties of transactions become the settlement counterparts and netting is carried out between two institutions. But,
multilateral netting reduces a large number of individual positions or obligations to a small number of obligations or positions.

I. Settlement scheme (Gross-Gross, Gross-Net, Net-Net) for Corporate Bond, Government Bond and other debt securities

Settlement is the completion of a transaction, wherein the seller transfers securities or financial instruments to the buyer and the buyer transfers money to the seller.

Settlement is classified into DVP and FOP (Free of Payment) depending on connection and separation of delivery and payment.

The characteristic of DVP is to deliver and receive securities and funds at the same time. The characteristic of FOP is to deliver and receive securities and funds separately.

According to BIS, DVP model is divided into three types. First, DVP1 is the settlement method which in every transaction, delivery and receipt of securities and funds occurs in the whole quantity standard. In short, DVP1 is the settlement method of settling on a trade by trade basis. In DVP2, securities delivery occurs in Gross amount of standard, as soon as seller’s securities are fulfilled. But funds are netted at the end of processing cycle. In DVP3, Securities and Funds are settled by Net Basis occurring at the end of processing cycle. This model can economize the liquidity of securities and funds.

KRX provides clearing services as a CCP for Stock Market and KOSDAQ Market. KRX also provides clearing and settlement services for the Futures Market. Meanwhile, KSD provides settlement services for cash market, like Stock market and KOSDAQ market.

Unlike the KRX Market, KSD provides clearing services as well as settlement services for FreeBoard, Stock's OTC Market, and Bond's OTC Market. Especially, we call the settlement for stock OTC market and bond OTC market as institutional settlement.

J. Settlement cycle for Corporate Bond, Government Bond and other debt securities

The settlement cycle is T+2 for stock transactions and KSD employs DVP Model 3 (Netting of Securities and Cash). Currently, KSD is providing settlement services for Exchange transactions, institutional transactions, and OTC transactions.

1. What are the Benefits?

a. Low Cost-High Efficiency Back-office Infrastructure Service

All the post-trade processes such as trade reporting, confirmation, settlement data production, and settlement result notification are processes through KSD, which has led to the automation and standardization of post-trade operations carried out by KSD.

As a result, KSD plays the role of the low cost ? high efficiency back-office infrastructure, sharply reducing the operational burden of KSD participants.

b. Settlement Obligation Reduction
Thanks to the net settlement system of KSD, settlement system participants can benefit from settlement obligation cut and risk reduction. For example, participants of the Bond Institutional Settlement System are enjoying, on average, a daily settlement liquidity reduction of about KRW 5 trillion.

c. Credit Enhancement

The settlement system guarantees settlement finality. Therefore, brokers can trade with any counterparty regardless of his credibility. In other words, as settlement risk (counterparty risk) is removed by KSD, they can trade with any counterparty that they would like to trade with.

[www.ksd.or.kr>KSD services>Core Service>Settlement]

K. Brief history of the development of the Securities settlement infrastructure

<table>
<thead>
<tr>
<th>Classification</th>
<th>Period</th>
<th>Settlement system</th>
</tr>
</thead>
<tbody>
<tr>
<td>Early stage of modernization</td>
<td>1956-1967</td>
<td>Latter settlement system</td>
</tr>
<tr>
<td>Capital market development</td>
<td>1969-1978</td>
<td>The latter settlement system had shifted new regular-way system</td>
</tr>
<tr>
<td>Market liberalization</td>
<td>1979-1985</td>
<td>The securities deposit system was established to enhance effectiveness of the book-entry clearing system</td>
</tr>
<tr>
<td>Expansion of the capital market</td>
<td>1986-1995</td>
<td>The settlement of bonds traded between institutional investors was required to be carried out through wire transfer via the KSD in order to avoid risks and inefficiency in the settlement process.</td>
</tr>
<tr>
<td>Asian financial crisis and reform measures</td>
<td>1996-2003</td>
<td>The BOK-Wire with the book-entry system of KSD for DVP of the OTC bond transactions is introduced.</td>
</tr>
<tr>
<td>Enhanced competitiveness of the capital market</td>
<td>2004-2009</td>
<td></td>
</tr>
</tbody>
</table>

Source: 2010, Capital Market in Korea

Most bonds are traded in the OTC market. KSD operates the OTC Bond Market Settlement System to process bond transactions traded on the OTC market. DVP settlement of bonds and funds is conducted through RTGS during the business hours of the next business day after the trade date once the required bonds and funds have been secured.

KSD is not liable for failed trades that must be handled directly by the involved parties. Since November 1999, the BOK has linked BOK-Wire with the book-entry system of KSD for DVP of the OTC bond transactions and therefore eliminating principal risk in OTC bond transactions.

The OTC market operates efficiently because of the existence of a very well functioning clearance and settlement system operated by KSD with direct linked to BOK-Wire.

<table>
<thead>
<tr>
<th>Korea Securities Market Settlement System</th>
</tr>
</thead>
<tbody>
<tr>
<td>Participants</td>
</tr>
<tr>
<td>Banks and securities companies</td>
</tr>
<tr>
<td>Clearing house</td>
</tr>
<tr>
<td>Settlement agency</td>
</tr>
<tr>
<td>Settlement method</td>
</tr>
<tr>
<td>Settlement date</td>
</tr>
<tr>
<td>DVP</td>
</tr>
<tr>
<td>Fund settlement</td>
</tr>
<tr>
<td>Securities Settlement</td>
</tr>
</tbody>
</table>

Source: Bank of Korea
L. Issues on current settlement infrastructures

With relative higher quantity growth of Korean securities market, enhancement of the
Securities Settlement System is being pursued for the stability and the competitive
edge. KSD is now developing the new securities settlement system.

<Main contents of the new securities settlement system>

<table>
<thead>
<tr>
<th>Category</th>
<th>AS-IS</th>
<th>TO-BE</th>
<th>Organizations</th>
</tr>
</thead>
<tbody>
<tr>
<td>Stock Exchange Settlement</td>
<td>DVP3(DNS)</td>
<td>DVP3(CNS)</td>
<td>KSD, KRX</td>
</tr>
<tr>
<td>Institutional Settlement</td>
<td>DVP3</td>
<td>DVP2</td>
<td>KSD</td>
</tr>
<tr>
<td>Government Bond Settlement</td>
<td>DVP3</td>
<td>DVP1</td>
<td>KSD, KRX</td>
</tr>
<tr>
<td>Liquidity Provision</td>
<td>-</td>
<td>Intraday RP system</td>
<td>KSD, BOK</td>
</tr>
<tr>
<td>Stock Exchange Payment</td>
<td>Shinhan Bank,</td>
<td>BOK</td>
<td>KSD, BOK</td>
</tr>
<tr>
<td>Settlement Bank</td>
<td>Woori Bank</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

M. Expected changes on settlement infrastructures

1. Enhancement of efficiency in securities settlement
   - (Stock exchange, Government bond) Through putting settlement beginning
timing forward, try to increase speed of settlement
   - (Stock exchange) By re-deducting settlement which is carried over through CNS,
reduce settlement volume
   - (Institutional settlement of stocks) In line with DVP2 method, reduce settlement
amount by KRW1.2 trillion. per day(Reduction by 64% )
   - (Intraday RP) By providing liquidity required for government bond settlement, try
to activate settlement

2. Enhancement of safety of securities settlement
   - (Stock exchange) By changing settlement bank into BOK, enhance safety of
settlement
   - (Institutional settlement of stocks) With introduction of CCP system, get rid of
risks of non-performance of settlement
   - (Gov't bond) Settlement in line with DVP1 after deduction will result in removal of
risks
   - (Intraday RP) Solve settlement concentration by providing liquidity required for
government bond settlement

3. Scientific settlement risk management

(Stock exchange) Improve settlement risk management through management of
collectable limit of securities

(Institutional settlement of stocks) Remove advance settlement risk through net liability
limit management and surplus value management, etc.
VI. Costs and charging methods

A. Registration fee at CSD

<table>
<thead>
<tr>
<th>Classification</th>
<th>Fee rate</th>
</tr>
</thead>
</table>
| Domestic entity issuing bond | - KRW 10 billion and less: ₩100,000  
- KRW 10 billion and more: Registration amount × 1/100,000  
(Ceiling: ₩500,000) |
| Foreign entity issuing bond | - KRW 10 billion and less: ₩500,000  
- KRW 10 billion and more: Registration amount × 5/100,000  
(Ceiling: ₩10,000,000) |

B. Transfer fee (book transfer fee) at CSD

KRW 1,000 per transaction levies on transferor

C. Average on-going costs for debt instruments

Maintenance fee (Deposit fee) at CSD (monthly basis)

<table>
<thead>
<tr>
<th>Range</th>
<th>Fee rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>KRW 1 trillion and less</td>
<td>₩0.00125 per KRW 10,000</td>
</tr>
<tr>
<td>Over KRW 1 trillion up to KRW 3 trillion</td>
<td>₩125,000 + ₩0.001 per KRW 10,000</td>
</tr>
<tr>
<td>Over KRW 3 trillion</td>
<td>₩325,000 + ₩0.00075 per KRW 10,000</td>
</tr>
</tbody>
</table>

Interest payment / redemption fee at CSD - N/A

D. Market Charges

Brokerage Commission

Brokerage commission is determined by each broker company. Normally, brokerage commission rates range as follows:

<table>
<thead>
<tr>
<th>Security</th>
<th>Rate</th>
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<tr>
<td>Equities on KRX</td>
<td>0.4% - 0.5%</td>
</tr>
<tr>
<td>Equities in OTC</td>
<td>0.5%</td>
</tr>
<tr>
<td>Bonds in KRX</td>
<td>0.1% - 0.3%</td>
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<tr>
<td>Bonds in OTC</td>
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</table>
VII. Market size / statistics

A. Bonds issued

(Unit: KRW billion)

<table>
<thead>
<tr>
<th>year</th>
<th>Treasury Bonds</th>
<th>National Housing Bonds</th>
<th>Industrial Finance Debentures</th>
<th>For. Exch. Sta. Fund Bonds</th>
</tr>
</thead>
<tbody>
<tr>
<td>2001</td>
<td>21,830.1</td>
<td>5,439.6</td>
<td>9,631.7</td>
<td>3,000.1</td>
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<tr>
<td>2002</td>
<td>19,350.1</td>
<td>7,617.6</td>
<td>12,350.1</td>
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<tr>
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<td>13,964.9</td>
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<tr>
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<td>62,550.0</td>
<td>8,299.1</td>
<td>21,761.4</td>
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<tr>
<td>2006</td>
<td>60,608.2</td>
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<td>24,756.6</td>
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<td>8,550.4</td>
<td>21,150.1</td>
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<tr>
<td>2008</td>
<td>52,054.0</td>
<td>8,472.8</td>
<td>26,519.0</td>
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<tr>
<td>2009</td>
<td>84,976.0</td>
<td>9,544.4</td>
<td>23,333.4</td>
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Outstanding amount of bonds issued (Unit: KRW billion)

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<tr>
<th>year</th>
<th>Treasury Bonds</th>
<th>National Housing Bonds</th>
<th>Industrial Finance Debentures</th>
<th>For. Exch. Sta. Fund Bonds</th>
</tr>
</thead>
<tbody>
<tr>
<td>2001</td>
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<td>482.8</td>
<td>87,194.9</td>
<td>206,212.7</td>
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<td>69,840.4</td>
<td>561.7</td>
<td>77,522.0</td>
<td>194,741.9</td>
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<td>2003</td>
<td>91,735.0</td>
<td>549.2</td>
<td>61,757.6</td>
<td>217,417.0</td>
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<td>2004</td>
<td>134,722.5</td>
<td>473.0</td>
<td>50,379.0</td>
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<td>545.6</td>
<td>48,103.0</td>
<td>306,294.4</td>
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<td>2006</td>
<td>150,048.7</td>
<td>391.3</td>
<td>41,678.2</td>
<td>288,164.2</td>
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<tr>
<td>2007</td>
<td>156,850.0</td>
<td>553.0</td>
<td>45,250.8</td>
<td>286,462.3</td>
</tr>
<tr>
<td>2008</td>
<td>151,390.0</td>
<td>359.7</td>
<td>52,756.5</td>
<td>281,554.0</td>
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<tr>
<td>2009</td>
<td>375,460.0</td>
<td>633.4</td>
<td>84,206.1</td>
<td>578,155.3</td>
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</table>

<table>
<thead>
<tr>
<th>year</th>
<th>Treasury Bonds</th>
<th>National Housing Bonds</th>
<th>Industrial Finance Debentures</th>
<th>For. Exch. Sta. Fund Bonds</th>
</tr>
</thead>
<tbody>
<tr>
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<td>29,645.0</td>
<td>24,303.9</td>
<td>8,699.9</td>
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<td>2002</td>
<td>55,615.2</td>
<td>25,706.6</td>
<td>24,010.2</td>
<td>15,849.9</td>
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<tr>
<td>2003</td>
<td>81,483.3</td>
<td>30,056.6</td>
<td>25,232.4</td>
<td>23,649.9</td>
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<tr>
<td>2004</td>
<td>123,061.3</td>
<td>32,347.7</td>
<td>28,945.4</td>
<td>22,199.9</td>
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<tr>
<td>2005</td>
<td>170,475.2</td>
<td>37,086.0</td>
<td>30,744.7</td>
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<td>2006</td>
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<td>42,853.5</td>
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<td>8,100.0</td>
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<tr>
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<td>227,373.3</td>
<td>43,369.9</td>
<td>41,604.1</td>
<td>3,000.0</td>
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<tr>
<td>2008</td>
<td>239,290.3</td>
<td>44,920.7</td>
<td>49,538.4</td>
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<tr>
<td>2009</td>
<td>280,853.3</td>
<td>48,262.8</td>
<td>35,069.3</td>
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</tbody>
</table>

<table>
<thead>
<tr>
<th>year</th>
<th>Treasury Bonds</th>
<th>National Housing Bonds</th>
<th>Industrial Finance Debentures</th>
<th>For. Exch. Sta. Fund Bonds</th>
</tr>
</thead>
<tbody>
<tr>
<td>2001</td>
<td>79,121.3</td>
<td>3,057.4</td>
<td>154,400.4</td>
<td>341,226.9</td>
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<tr>
<td>2002</td>
<td>84,277.9</td>
<td>3,136.5</td>
<td>180,045.5</td>
<td>399,244.8</td>
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<tr>
<td>2003</td>
<td>105,496.7</td>
<td>2,945.4</td>
<td>187,350.9</td>
<td>490,214.2</td>
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<tr>
<td>2004</td>
<td>142,733.0</td>
<td>3,061.0</td>
<td>153,283.1</td>
<td>565,371.4</td>
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<tr>
<td>2005</td>
<td>155,230.5</td>
<td>3,319.5</td>
<td>142,549.6</td>
<td>554,710.0</td>
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<tr>
<td>2006</td>
<td>158,390.0</td>
<td>3,382.8</td>
<td>134,420.4</td>
<td>589,364.7</td>
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<td>150,340.0</td>
<td>3,457.1</td>
<td>135,663.6</td>
<td>604,775.0</td>
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<tr>
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<td>126,837.2</td>
<td>3,410.1</td>
<td>149,803.7</td>
<td>613,906.4</td>
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<tr>
<td>2009</td>
<td>149,237.2</td>
<td>3,520.7</td>
<td>180,748.7</td>
<td>765,683.6</td>
</tr>
</tbody>
</table>
The text is too large to be displayed here in full. However, if you need a specific part of the document or have any questions regarding the content, please let me know, and I can assist you with that.
B. Summary of Bond Market

1. Government Bonds

<table>
<thead>
<tr>
<th>Year</th>
<th>No. of Listed Issues (Issue)</th>
<th>Listed Amount (mil.KRW)</th>
<th>Trading Volume (mil.KRW)</th>
<th>Trading Value (mil.KRW)</th>
</tr>
</thead>
<tbody>
<tr>
<td>2009</td>
<td>4,610</td>
<td>759,763,881</td>
<td>499,624,032</td>
<td>505,507,509</td>
</tr>
<tr>
<td>2008</td>
<td>4,517</td>
<td>636,825,046</td>
<td>373,251,334</td>
<td>370,762,361</td>
</tr>
<tr>
<td>2007</td>
<td>3,967</td>
<td>622,049,124</td>
<td>352,833,049</td>
<td>346,128,945</td>
</tr>
<tr>
<td>2006</td>
<td>3,725</td>
<td>592,527,160</td>
<td>292,386,815</td>
<td>291,738,827</td>
</tr>
<tr>
<td>2005</td>
<td>3,720</td>
<td>552,100,020</td>
<td>364,654,474</td>
<td>361,764,775</td>
</tr>
<tr>
<td>2004</td>
<td>3,715</td>
<td>483,075,676</td>
<td>375,250,547</td>
<td>383,003,366</td>
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<tr>
<td>2003</td>
<td>3,823</td>
<td>403,487,311</td>
<td>47,705,891</td>
<td>47,406,345</td>
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<tr>
<td>2002</td>
<td>3,779</td>
<td>333,768,259</td>
<td>3,337,915</td>
<td>2,871,119</td>
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<tr>
<td>2001</td>
<td>5,587</td>
<td>362,313,205</td>
<td>10,144,588</td>
<td>10,563,909</td>
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</table>

2. Corporate Bonds

<table>
<thead>
<tr>
<th>Year</th>
<th>No. of Listed Issues (Issue)</th>
<th>Listed Amount (mil.KRW)</th>
<th>Trading Volume (mil.KRW)</th>
<th>Trading Value (mil.KRW)</th>
</tr>
</thead>
<tbody>
<tr>
<td>2009</td>
<td>4,915</td>
<td>254,202,029</td>
<td>4,758,339</td>
<td>4,686,720</td>
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<tr>
<td>2008</td>
<td>4,772</td>
<td>228,563,943</td>
<td>3,099,550</td>
<td>3,222,349</td>
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<tr>
<td>2007</td>
<td>4,573</td>
<td>208,053,476</td>
<td>2,995,054</td>
<td>3,266,965</td>
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<tr>
<td>2005</td>
<td>4,446</td>
<td>185,376,346</td>
<td>1,751,481</td>
<td>1,868,993</td>
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<tr>
<td>2005</td>
<td>4,627</td>
<td>168,338,983</td>
<td>1,940,894</td>
<td>2,038,238</td>
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<tr>
<td>2004</td>
<td>4,920</td>
<td>175,232,364</td>
<td>1,192,147</td>
<td>1,065,581</td>
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<tr>
<td>2003</td>
<td>5,095</td>
<td>202,951,242</td>
<td>1,024,674</td>
<td>915,451</td>
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<td>4,786</td>
<td>209,411,446</td>
<td>1,958,765</td>
<td>1,111,415</td>
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<tr>
<td>2001</td>
<td>2,328</td>
<td>141,524,144</td>
<td>1,119,670</td>
<td>1,161,771</td>
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C. Bond Trading Volume & Value

1. Trading Volume

<table>
<thead>
<tr>
<th>Year</th>
<th>No. of Trading Days</th>
<th>Government Bonds</th>
<th>Ordnary Bonds</th>
<th>Total</th>
<th>Daily Avg.</th>
<th>High(Date)</th>
<th>Low(Date)</th>
</tr>
</thead>
<tbody>
<tr>
<td>2009</td>
<td>253</td>
<td>428,790,000</td>
<td>74,109,037</td>
<td>502,899,037</td>
<td>1,993,006</td>
<td>3,543,460</td>
<td>221,463</td>
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<tr>
<td>2008</td>
<td>248</td>
<td>321,190,000</td>
<td>53,098,614</td>
<td>374,288,614</td>
<td>1,517,514</td>
<td>2,802,094</td>
<td>247,659</td>
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<tr>
<td>2007</td>
<td>246</td>
<td>316,511,000</td>
<td>37,671,185</td>
<td>354,182,185</td>
<td>1,446,066</td>
<td>2,790,809</td>
<td>104,507</td>
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<tr>
<td>2006</td>
<td>247</td>
<td>267,401,000</td>
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<td>287,450,296</td>
<td>1,196,105</td>
<td>2,543,500</td>
<td>126,900</td>
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<tr>
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<td>337,690,000</td>
<td>27,664,690</td>
<td>365,354,690</td>
<td>1,467,368</td>
<td>3,303,984</td>
<td>107,334</td>
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<td>356,480,000</td>
<td>19,085,235</td>
<td>375,565,235</td>
<td>1,516,005</td>
<td>3,570,013</td>
<td>63,784</td>
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<tr>
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<td>207,930,000</td>
<td>4,664,224</td>
<td>212,594,224</td>
<td>960,027</td>
<td>2,554,450</td>
<td>12,942</td>
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<td>5,296,680</td>
<td>47,896,680</td>
<td>196,298</td>
<td>866,720</td>
<td>7,681</td>
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<td>3,715,293</td>
<td>13,815,293</td>
<td>56,160</td>
<td>658,210</td>
<td>5,285</td>
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2. Trading Value

<table>
<thead>
<tr>
<th>Year</th>
<th>No. of Trading Days</th>
<th>Government Bonds</th>
<th>Ordnary Bonds</th>
<th>Total</th>
<th>Daily Avg.</th>
<th>High(Date)</th>
<th>Low(Date)</th>
</tr>
</thead>
<tbody>
<tr>
<td>2009</td>
<td>253</td>
<td>441,999,275</td>
<td>66,717,046</td>
<td>508,716,321</td>
<td>2,015,578</td>
<td>3,670,877</td>
<td>201,741</td>
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<tr>
<td>2008</td>
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<td>325,261,756</td>
<td>46,634,086</td>
<td>371,895,842</td>
<td>1,507,074</td>
<td>2,831,526</td>
<td>220,306</td>
</tr>
<tr>
<td>2007</td>
<td>247</td>
<td>315,820,757</td>
<td>33,921,678</td>
<td>349,742,435</td>
<td>1,428,044</td>
<td>2,784,832</td>
<td>94,810</td>
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<tr>
<td>2006</td>
<td>247</td>
<td>259,397,502</td>
<td>25,655,259</td>
<td>285,052,761</td>
<td>1,194,660</td>
<td>2,554,749</td>
<td>115,155</td>
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<td>337,217,666</td>
<td>25,743,034</td>
<td>363,960,699</td>
<td>1,455,574</td>
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<td>2004</td>
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<td>366,484,769</td>
<td>17,526,988</td>
<td>384,011,757</td>
<td>1,542,617</td>
<td>3,396,974</td>
<td>63,970</td>
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<tr>
<td>2003</td>
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<td>211,042,634</td>
<td>4,304,017</td>
<td>215,346,651</td>
<td>871,850</td>
<td>2,575,564</td>
<td>11,056</td>
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<td>2002</td>
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<td>3,969,534</td>
<td>7,161,230</td>
<td>190,337</td>
<td>862,632</td>
<td>6,234</td>
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<td>10,529,611</td>
<td>3,597,598</td>
<td>14,127,208</td>
<td>57,830</td>
<td>704,171</td>
<td>4,602</td>
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</table>


<table>
<thead>
<tr>
<th>Year</th>
<th>Trading Volume (ml.KRW)</th>
<th>Trading Value (ml.KRW)</th>
<th>National Housing Bond(1)</th>
<th>Seoul Subway</th>
<th>Local Development</th>
<th>Provincial Subway</th>
</tr>
</thead>
<tbody>
<tr>
<td>2009</td>
<td>64,433,995</td>
<td>57,679,346</td>
<td>5.87</td>
<td>6.85</td>
<td>0.00</td>
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<tr>
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<td>42,402,950</td>
<td>36,639,904</td>
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<td>7.50</td>
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<td>2007</td>
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<td>0.00</td>
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<tr>
<td>2006</td>
<td>17,147,420</td>
<td>15,422,268</td>
<td>5.71</td>
<td>5.98</td>
<td>0.00</td>
<td>5.85</td>
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<tr>
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<td>11,600</td>
<td>5.56</td>
<td>5.69</td>
<td>5.67</td>
<td>5.67</td>
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<tr>
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<td>5.77</td>
<td>6.20</td>
<td>0.12</td>
<td>6.13</td>
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<tr>
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<td>2,203,871</td>
<td>1,901,990</td>
<td>7.45</td>
<td>7.75</td>
<td>7.65</td>
<td>7.67</td>
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<tr>
<td>2001</td>
<td>809,077</td>
<td>730,324</td>
<td>7.59</td>
<td>8.21</td>
<td>9.05</td>
<td>8.12</td>
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</tbody>
</table>
### D. Trading Activity of Government Bond

![Trading Activity of Government Bond](http://asianbondsonline.adb.org/korea/data/bondmarket.php?code=LCY_in_USD_Local)

### E. Size of LCY Bond Market in USD

http://asianbondsonline.adb.org/korea/data/bondmarket.php?code=LCY_in_USD_Local

<table>
<thead>
<tr>
<th>Date</th>
<th>Govt. (in USD Billions)</th>
<th>Corp. (in USD Billions)</th>
<th>Total (in USD Billions)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Mar-95</td>
<td>60.63</td>
<td>-</td>
<td>60.63</td>
</tr>
<tr>
<td>Jun-95</td>
<td>60.48</td>
<td>-</td>
<td>60.48</td>
</tr>
<tr>
<td>Sep-95</td>
<td>62.72</td>
<td>-</td>
<td>62.72</td>
</tr>
<tr>
<td>Dec-95</td>
<td>67.01</td>
<td>-</td>
<td>67.01</td>
</tr>
<tr>
<td>Mar-96</td>
<td>66.75</td>
<td>-</td>
<td>66.75</td>
</tr>
<tr>
<td>Jun-96</td>
<td>69.80</td>
<td>-</td>
<td>69.80</td>
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F. Size of LCY Bond Market in % of GDP

\[ \text{http://asianbondsonline.adb.org/korea/data/bondmarket.php?code=LCY\_in\_GDP\_Local} \]

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VIII. Next Step → Future Direction

A. Future Direction

To be addressed later.

B. G-30 Compliance¹

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<td>1 Eliminate paper and automate communication, data capture, and enrichment.</td>
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<td>2 Harmonize messaging standards and communication protocols.</td>
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<td>3 Develop and implement reference data standards.</td>
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<td>4 Synchronize timing between different clearing and settlement systems and associated payment and foreign exchange systems.</td>
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<td>5 Automate and standardize institutional trade matching.</td>
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<td>6 Expand the use of central counterparties.</td>
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<td>7 Permit securities lending and borrowing to expedite settlement.</td>
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<td>8 Automate and standardize asset servicing processes, including corporate actions, tax relief arrangements, and restrictions on foreign ownership.</td>
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<td>9 Ensure the financial integrity of providers of clearing and settlement services.</td>
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<td>10 Reinforce the risk management practices of users of clearing and settlement service providers.</td>
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<td>11 Ensure final. Simultaneous transfer and availability of assets.</td>
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<td>12 Ensure effective business continuity and disaster recovery planning.</td>
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<td>13 Address the possibility of failure of a systematically important institution.</td>
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<td>14 Strengthen assessment of the enforceability of contracts.</td>
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<td>15 Advance legal certainty over rights to securities, cash, or collateral.</td>
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<td>16 Recognize and support improved valuation methodologies and closeout netting arrangements.</td>
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<td>17 Ensure appointment of appropriately experienced and senior board members (of the boards of securities clearing and settlement infrastructure providers).</td>
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<td>18 Promote fair access to securities clearing and settlement networks.</td>
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<td>19 Ensure equitable and effective attention to stakeholder interests.</td>
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<td>20 Encourage consistent regulation and oversight of securities clearing and settlement service providers.</td>
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¹ The G30 recommendations are taken from the Group of Thirty’s report Global Clearing and Settlement – A plan of action (Copyright © 2003 Group of Thirty) http://www.partad.ru/wrld/word/g30app1.pdf
### Potential barrier areas

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<th>Overall barrier assessment</th>
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<td><strong>Investor registration</strong></td>
<td>Foreign investors must obtain an investment registration certificate (IRC) prior to investing in Korea. The IRC contains a unique identification number, which notes the foreign investor’s nationality and other information. The IRC number is used in all trading, settlement and registration activities. Foreign investors may apply for a single IRC covering both equities and bonds. The requirements are well defined and do not appear onerous - e.g. only one document needs notarisation. We are told that IRC can be issued 1 day after submission. However, there is an investor perception of difficulties in this area. Appears to be some controversy over ‘parent child’ area regarding splitting or consolidating holdings over a number of sub-funds. Perception gap - there appears to be a perception among many investors that registration requirements are onerous.</td>
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<td><strong>FX controls - conversion</strong></td>
<td>Since December 2007, foreign investors are allowed to buy the KRW without any underlying securities trade. Perception gap - there appears to be a perception among many investors that FX controls are still in place.</td>
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<td><strong>FX controls - repatriation of funds</strong></td>
<td>There is no restriction on the repatriation of income or proceeds from the sale of securities. Sales proceeds converted into foreign currency can either be remitted overseas or held in onshore foreign currency accounts.</td>
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<td><strong>Cash controls - credit balances</strong></td>
<td>Foreign investors can buy an unlimited amount of KRW, keep it as cash, fund a purchase trade or re-convert back into FCY.</td>
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<td><strong>Cash controls - overdrafts</strong></td>
<td>Sales proceeds can be used to fund purchase trades having the same settlement date. In theory, foreign investors can borrow up to KRW 1 billion without any restriction, and up to KRW 30 billion with prior notification to the central bank. However, banks are not allowed to lend to foreign investors for a “speculative” purpose in securities, which is not clearly defined, and hence in practice overdrafts are not provided. There is a current proposal to the National Assembly to lift this restriction.</td>
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<tr>
<td><strong>Taxes</strong></td>
<td>The default tax rate to foreign investors is 22% on cash balance interest and dividends and 15.4% on interest income on debt securities. The rates of withholding tax and CGT may be reduced under applicable double taxation agreements, subject to documentation. Historical information is needed to calculate the tax. There is no officially recognised tax reclaim procedures. Taxes may be reclaimed on a case by case basis, although the reclaim is not guaranteed. There is a perception among foreign investors that tax is high. This appears to be incorrect and may reflect previous higher rates. The government has proposed that foreign investors will be exempt from interest and capital gains tax for income from government bonds and monetary stabilisation bonds.</td>
<td>LOW</td>
<td>HIGH</td>
</tr>
<tr>
<td><strong>Omnibus accounts</strong></td>
<td>Omnibus accounts in general are not permitted. However, as from 1 January 2008, omnibus accounts in the name of ICSDs at KSD are permitted for foreign investors buying and selling Korean government bonds and monetary stabilisation bonds. Accounts must be held on an individual basis at the sub-custodian, with the global custodian designation. Due to tax and other restrictions, ICSDs have been slow to open links although these have now been announced.</td>
<td>HIGH</td>
<td>HIGH</td>
</tr>
<tr>
<td>Potential barrier area</td>
<td>Current situation</td>
<td>Market Assessment Questionnaire scores</td>
<td>Overall barrier assessment</td>
</tr>
<tr>
<td>----------------------------</td>
<td>-----------------------------------------------------------------------------------</td>
<td>----------------------------------------</td>
<td>-----------------------------</td>
</tr>
<tr>
<td>Settlement cycle</td>
<td>The settlement cycle for bonds is: T+1(or by agreement).</td>
<td>OK</td>
<td>OK</td>
</tr>
<tr>
<td>Message formats</td>
<td>KSD, and most local market participants, use SWIFT message formats. KSD uses SWIFT for both settlement and corporate event messages.</td>
<td>OK</td>
<td>OK</td>
</tr>
<tr>
<td>Securities numbering</td>
<td>ISIN codes are available for all local bond issues, and are available at the time of issue. ISIN can be allocated at any time through the online allocating system of the KRX. KSD, and most local market participants, use ISIN.</td>
<td>OK</td>
<td>OK</td>
</tr>
<tr>
<td>Matching</td>
<td>There is no trade matching or pre-settlement matching system for bonds.</td>
<td>LOW</td>
<td>LOW</td>
</tr>
<tr>
<td>Dematerialisation</td>
<td>Almost all bonds are dematerialised, or immobilised at KSD.</td>
<td>OK</td>
<td>OK</td>
</tr>
<tr>
<td>Regulatory framework</td>
<td>The regulatory regime is regarded as stable and consistent although some investors mentioned high penalties for non-compliance, and that local custodians take a very cautious view. It is clear that the Korean government is making serious efforts to attract foreign investors.</td>
<td>-</td>
<td>OK</td>
</tr>
</tbody>
</table>
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- Dr. Hyun Suk   KCMi
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- KRX
- KSD
- Deutsche Bank Domestic Custody Services, Market Guide Thailand, November 2009
- State Street
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- asianbondsonline.adb.org

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ABMF SF-1

Japan Bond Market Guide

Version: No.2_26/June/2011
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I. High Level Structure, Type & Characteristics of the Bond Market

A. 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. Government agency bonds (政府関係機関債) (Public sector bonds)
   a. Japanese Government-guaranteed bond (政府保証債)
   b. 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).
   c. 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)
   a. Straight corporate bonds, etc. (普通社債等)
   b. Asset Backed corporate bonds (資産担保型社債)
   c. Convertible bonds (転換社債),

7. Bank debentures (金融債), and

8. Nonresident bonds (foreign bonds) (非居住者債)
   a. Yen-denominated foreign bonds (円建て外債)(サムライ債)
   b. 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 (FIEA). All other bonds are exempt from FIEA 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;

a. Short-term bills (maturing in one year or less),

b. Medium-term notes (maturing in two to five years),

c. Long-term bonds (maturing in six to ten years) and

d. 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.

Subsequently, the government started issuing

a. ten-year CPI (consumer price index)-linked bonds,

b. five-year bonds for retail investors and


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.”

3. Government agency bonds

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

Agency bonds are divided into

a. Government-Guaranteed bonds that are backed by the full faith and credit of the government,

b. FILP-Agency bonds, those bonds are issued by treasury investment and loan agencies that do not enjoy such guarantee, and
c. 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.

B. Securitized Products

The Securitized Products Market

1. Securitized Products

The income-generating assets of a company are pooled separately from its balance sheet into a special-purpose vehicle (SPV), and the SPV issues a security backed by the cash flow to be generated by such assets and sells the security to investors.

This method is called “securitization.” And the security issued through such a process is generally called a “securitized product.”

Business enterprises use their assets—such as auto loans, mortgage loans, leases receivable, business loans, and commercial real estate—as collateral to back up their securitized products.

As defined by the Asset Liquidation Law, intellectual property (such as copyrights and patents) also can be securitized.

When viewed from the standpoint of asset holders, securitization of assets has the advantage of enabling them to use the proceeds of the assignment or sale of such assets that they obtain at the time of issue in exchange for cash flows that may be generated by the assets over a future period of years.

In other words, asset holders can monetize uncertain future cash flows into current income. At the same time, the practice offers asset holders the advantage of freeing them from the risk of a fall in the price of their assets.
In addition, in case any holder of a piece of less-liquid commercial real estate wants to issue a security by putting up such real estate as collateral, such asset holder may easily sell the security by issuing it in small denominations to attract a larger number of small investors.

When viewed from the standpoint of investors, securitized products give them an additional choice of investments that have a new character.

More specifically, first, a security backed by a piece of real estate gives them an opportunity to invest in real estate that otherwise they cannot afford to buy outright with a small sum of money.

Second, as asset holders can issue different classes, or tranches, of securities (“the senior/subordinated structure”) at one and the same time with varying levels of credit risks, they offer investors the opportunity to purchase a security that meets their needs.

The issuers of asset-backed securities—Security 1 to Security N on chart VIII-1—simply tailor their terms of issue to best suit the needs of Investor 1 to Investor N, instead of making them uniform.

For instance, by issuing securities with different characters—differentiation of the order of priority for the payment of interest and redemption of principal or granting credit-enhancing conditions (credit enhancement)—the scope of choice for investors can be enlarged. By adding such new wrinkles, investors can restructure their portfolios into more efficient ones.

2. Basic Mechanism of Issuing Securitized Products

Generally, many of the securitized products are issued through the mechanism described below.

First, the holder of assets (“originator”) such as mortgage loans and accounts receivable that are to be securitized assigns them to a SPV.

By doing so, such assets are separated from the balance sheet of the originator and become assets of the SPV, which becomes the holder of the assets.

An SPV may take the form of a partnership, a trust, or a special-purpose company (SPC), and most SPVs take the form of an SPC.

And an SPC established under the Asset Liquidation Law is called tokutei mokuteki kaisha (TMK, or a specific-purpose company).

The next step is to formulate the terms of issue of the securitized product to be issued by the SPV.

If the originator opts for the trust method, it issues beneficiary certificates like those of a trust company. If it chooses the SPC method, it issues the kinds of securities decided upon by the SPC, but it does not have to issue them on one and the same terms of issue.

In short, it can design each type (tranche) of security with a different character by differentiating the order of priority with respect to the payment of interest and redemption of principal, by varying maturities, or by offering the guarantee of a property and casualty insurance company.
By adding such variation, the originator can issue securities that meet the diverse needs of investors. In the order of priority for payment, such securities are called “senior securities,” “mezzanine securities,” or “subordinated securities.”

When the originator plans to sell its securitized products to an unspecified large number of investors, it should make them readily acceptable to investors by offering them objective and simple indicators (credit ratings) for independently measuring the risks involved.

In addition, there are other players involved in different processes of securitized products, such as servicers, who manage assets that have been assigned to an SPV and securitized and also recover funds under commission from the SPV, and bond management companies, which administer the securitized products (corporate bonds) purchased by investors.

Firms that propose such a mechanism for securitizing assets and that coordinate the issuing and the sale of such products are called “arrangers,” and securities companies and banks often act as arrangers.

3. Description of Major Securitized Products

Securitized products are divided into several groups according to the types of assets offered as collateral and the character of the securities issued.

Those belonging to the group of products that are backed by real estate and the claims collateralized by it are residential mortgage-backed securities (RMBS), commercial mortgage-backed securities (CMBS), and real estate investment trusts (REIT).

RMBSs are issued in retail denominations against a portfolio that pools home mortgage loans. The first securitized product based on residential mortgage loans was the residential mortgage loan trust launched in 1973.

However, this product failed to attract the attention of both issuers and investors because of too much limitation. Nevertheless, as the scheme based on SPC became available thereafter, thanks to the enforcement of the SPC Law, the volume of this type of issue has increased since 1999.

Although bonds backed by housing loans that have been issued by the Japan Housing Finance Agency since 2001 were not issued through an SPC, they may be included among the RMBSs.

CMBSs are backed by loans given against the collateral of commercial real estate (office buildings, etc.). The mechanism of issuing them is almost the same as that for RMBSs.

The REIT that became available by virtue of enforcement of the Investment Trust and Investment Corporation Law in May 2000 is an investment trust in that it can only invest real estate and loans backed by real estate.

Another group consists of securities backed by assets (ABS, narrowly defined), such as accounts receivable, leases receivable, credits, auto loans, and consumer loans, etc. Sales of these products began to increase following the enforcement of the Specified Claims Law in June 1993.
As these collateralized assets are a collection of relatively small assets and can be dispersed, they are highly suitable for securitization. What is more, as the laws governing the products have since been developed, they are securitized more extensively than the real estate backed group.

Other securitized products are called “collateralized debt obligations” (CDO: securities issued against the collateral of general loans, corporate bonds, credit risks of loans that are held by banking institutions).

For instance, loans to small and medium-sized business enterprises that are securitized may be considered CDOs. And CDOs are subdivided into collateralized loan obligations (CLO) and collateralized bond obligations (CBO).

Moreover, since the eligibility requirements for issuing commercial paper (CP) were abolished in 1996, an increasing number of business corporations have come to use asset-backed commercial paper (ABCP).

4. The Size of the Market

The balance of outstanding structured-financing instruments (credit securitization–related products), one of the items listed in the Flow-of-Funds Statistics published by the Bank of Japan, can be considered a component of the scale of the securitized products market.

According to these statistics, the balance of credit securitization–related products outstanding as of March 31, 2008, stood at almost ¥30 trillion ($333.3 billion at the rate of ¥90 to the dollar).

When compared with that of stocks and equity investment (¥490 trillion or $5.44 trillion); industrial bonds (¥68 trillion or $755.5 billion); and bank debentures (¥21 trillion or $344.4 billion), their share of private-sector financing as a whole is not very large.

In contrast, the similar balance (of ABS and government agency MBS combined) in the United States, which is considered the most advanced in securitizing claims, stood at about ¥887 trillion ($9.8 trillion) at the end of fiscal 2008.

However, it is noteworthy that the scale of the securitized products market that stood at a mere ¥400 billion ($4.44 billion) at the end of fiscal 1989 has increased sharply thanks to the enforcement of the Specified Claims Law in 1993 (repealed in 2004) and the Special-Purpose Companies Law in 1998 and the Asset Liquidation Law in 2000.

This also suggests that assets that can be used as collateral have diversified and that asset securitization has found a growing number of applications.

Looking back, the issuance of securities backed by installment credits, which was made possible by the enactment of the Specified Claims Law, was the engine of growth of the market.

As these assets have short maturities and can be readily pooled for diversification, they carry relatively low risks and can be securitized, and such attributes have been a factor in expanding the scale of the market for them.

Since 2000, following the enforcement of the Asset Liquidation Law, the securitization of mortgage loans, as well as of loans to business corporations and the government, has
expanded dramatically.

This may be explained by the fact that, pressed by the need to raise the capital adequacy ratio in compliance with the BIS requirements, as well as in response to the prompt corrective measures issued by the Financial Services Agency, banks have sought to unload loan assets from their balance sheets.

After reaching a peak in fiscal 2006, the volume of securitized products has gone into decline under the impact, etc., of the weakening of the economy set off by the subprime loan crisis.

Among assets underlying credit securitization–related products, loans to business firms and the government had the largest share, accounting for 30.7% of the total at the end of fiscal 2008. They were followed in order by intercompany and trade credits, residential mortgages, installment credits, and consumer credits.

Within the Flow-of-Funds Statistics compiled by the Bank of Japan, “credit securitization–related products” are defined as financial products issued by structured financing SPCs and trusts.

More specifically, they include asset-backed securities (ABS) and beneficiary rights in monetary claim trusts.

However, as Fiscal Investment and Loan Program (FILP) bonds issued by the Japan Housing Finance Agency do not use such SPCs or trusts, they are not included in the definition.

It should also be noted that private placement instruments are not fully reflected in the statistics due to the difficulty of collecting the data.

5. New Issue Market for Securitized Products

As the bulk of securitized products are issued in private placement transactions between the parties concerned, it is difficult to accurately grasp the size of their market.

To remedy this shortcoming, underwriters that are involved in the transactions and credit rating agencies have been tracking the market on their own.

According to Deutsche Securities Inc., a leading underwriter, the total value of securitized products issued in Japan was about ¥5.5 trillion ($61.1 billion) in 2008. Although securitized products issuance reached a peak of ¥11 trillion ($122.2 billion) in 2006, levels have declined sharply over the past two years under the impact of the weakening of the economy kicked off by the subprime loan problem.

Even considering securitized products by types of collateral, issuance levels are down almost across the board.

Despite lease, credit card, and consumer loan credits being almost flat, residential mortgage loans and real estate–related credits have declined—a result that reflects the different sensitivities of these credits to economic fluctuations.

Residential mortgage loans account for nearly 50% of the underlying assets used as collateral, a trend that has not changed over the past few years.
This trend may be ascribed to the fact that lending banks have actively securitized mortgage loans of their own origination and that the Japan Housing Finance Agency has maintained a relatively high level of RMBS issuance.

According to the data compiled by the Japan Securities Dealers Association, the total value of such publicly offered asset-backed bonds had steadily increased since 1997, the year in which the association had started tracking the data.

After hitting a peak of ¥0.58 trillion ($6.4 billion) in 2002, however, the total has declined, falling to ¥0.28 trillion ($3.1 billion) in 2008.

This figure represents only 5% of privately placed ABSs.

The popularity of privately placed ABSs is thought to be the result of considerations with regard to investor protection framework, taxes, and disclosure cost.

It appears that the underwriting of these securitized products is concentrated in major brokers/dealers and bank-affiliated securities companies.

According to a league table published by Thomson Financial, a major information provider, top underwriters of those securitized products in 2008 were, in order of total underwriting volume, Daiwa Securities SMBC, Nomura Securities, Mitsubishi UFJ Financial Group, Shinsei Bank, and Mizuho Financial Group.

The list has shown little change over the past few years. It may be said that the results reflect their capabilities in distributing securitized products and procuring collateral assets, as well as securitization expertise that meets client needs.


With the exception of beneficiary certificates of real estate investment trusts (REITs; to be discussed later), trading in securitized products is not concentrated in stock exchanges at present.

This is perhaps because, as is the case with bonds, securitized products and their transactions are too complex and varied to lend themselves to exchange trading.

And this has led to the dependence on an over-the-counter interdealer market for their trading. In this section, we will overview the present state of the interdealer market of securitized products by use of data on “TMK bonds” published by the Japan Securities Dealers Association (JSDA), which is in a position to obtain data on interdealer transactions.

Data on the trading amounts of TMK bonds compiled on the basis of JSDA reports for the years prior to 1998 are not available. According to these reports, the trading amount of TMK bonds has fluctuated frequently, reaching a peak in 2008.

A comparison of TMK trading amounts with those of other bonds in 2008 shows that TMK bond trading amounted to ¥1.5 trillion ($16.6 billion at the then prevailing rate of ¥90), and those of corporate straight bonds and utility bonds stood at ¥39.8 trillion ($442.2 billion) and ¥12.3 trillion ($136.6 billion), respectively.

Although these issues constitute only a part of the securitized products market, it may be said that the asset-backed securities market of this country still remains underdeveloped.
The number of securities companies that offer them is quite limited, and their liquidity is considerably low.

On the other hand, a large number of securities companies make market in RMBS issued by the Japan Housing Finance Agency, the bonds are classified as FILP bonds for statistical purposes, and their market seems to have a certain degree of liquidity.

As their trading market is yet to attain maturity, it is difficult to precisely measure their secondary market yields, and they have to be substituted with yields at issue. Measured in terms of yields at issue, the most highly liquid Housing Loan Corporation bonds are traded at a higher yield than government-guaranteed bonds.

Reinvestment risk occasioned by early mortgage loan repayment and lower liquidity may be a factor behind this.

According to the balance of financial assets and liabilities of the Flow-of-Funds Accounts of the Bank of Japan, most of the holders of credit securitization–related products (securitized products) are nonfinancial corporations and banking institutions.

This is due to the fact that it is difficult to sell them to households because of the complexity of their structure and the lack of adequate explanation of their mechanism.

As a result, few individual investors hold credit securitization–related products at present, but it may be said that investment trusts incorporating securitized products have the potential of meeting their investment needs in the coming years.

7. New Issue and Secondary Markets for the Beneficiary Certificates of Real Estate Investment Trusts

On September 10, 2001, the Japan Building Fund Investment Corporation and the Japan Real Estate Investment Corporation listed their certificates on the Tokyo Stock Exchange and became the first public REITs in Japan.

These real estate investment trusts owe their birth to the amendment of the Investment Trust Law enforced in November 2000, which makes it possible to form trust funds through a real estate investment trust scheme.

In addition, the Tokyo Stock Exchange instituted a rule granting a special exception to the securities listing regulations in favor of real estate investment trust certificates and enforced it on March 1, 2001. By the end of 2008, the number of listed issues increased to 40.

The basic mechanism of REITs is this: investment corporations or investment managers called investment trust management companies pool funds of investors, invest such funds primarily in real estate, and distribute the investment income (including rent income) to investors.

The three types of securities defined in the Investment Trust Law—beneficiary certificates of investment trusts with instruction by trustor, beneficiary certificates of investment trusts without instruction by trustor, and investment securities of investment corporations—may also be issued by real estate investment trusts.

The first type of trust is managed by a trust company that holds the assets in custody in accordance with instructions given by the management company. The second type is
managed by a trust bank in accordance with its own judgment.

And the third is commissioned to a management company by the investment corporation that holds the assets.

All of the certificates of the REITs listed on the Tokyo Stock Exchange are investment securities issued by investment corporations.

One of the advantages investors can derive from REITs is that they are able to invest in real estate with a small amount of money, and they can enjoy liquidity in freely trading their investments in the market. Another is that REITs offer diversification to their investment portfolio.

REIT dividends may be expensed provided that a REIT meets certain requirements, including distributing more than 90% of its income to its certificate holders.

One problem that the managers of REITs have to address is the possibility of a conflict of interests between investors and the manager of a REIT with respect to any investment of its assets commissioned to a third party. In other words, it is feared that the management company may force the REIT to buy a piece of real estate held by its stockholders at a high price.

To avoid the occurrence of such a situation, it is desirable to require the REIT to fully disclose information concerning its investments.

And investors should consider getting involved in the management of investment companies through a general meeting of investors.

8. Risks and Credit Enhancement of Securitized Products

As the structure of securitized products is complex, credit rating is widely used as a criterion for making an investment decision.

And in order to package assets into a securitized product that merits a high credit rating, a device for controlling various risks has to be built into the product.

The substance of risks varies depending on the kind of underlying assets and the participants in the scheme, but one thing in common among them is the default risk, or the probability that the issuer may fail to pay its interest or principal promptly when due.

The default risk of a securitized product is largely divided into two kinds: the risk of changes occurring in the cash flow generated by the underlying assets (bad debt or arrears) and the risk of bankruptcy of parties involved in the securitization of assets (the debtor, the SPC, or the originator).

The risk involved in the cash flow may be reduced by taking various credit-enhancing measures. Unlike general corporate bonds, whose credit rating is determined by the credit risk of their issuers, the credit rating of a securitized product must be based on the results of examinations of assets underlying each product.

The arranger who underwrites and markets the securitized product and the originator negotiate with a credit-rating agency to obtain a high rating.

There are various credit-enhancing measures to choose from for different schemes.
employed for issuing a securitized product, but they may be largely divided into two: an external credit-enhancing measure that utilizes external credit (such as banking institutions) and an internal credit-enhancing measure that gives the structure of the security the function of enhancing its credit.

There are two methods of external credit enhancement: indirect and direct.

The former complements cash flows from underlying loan assets, and the latter complements that of a securitized product. The indirect method has a drawback in that it cannot eliminate risks associated with a servicer or any other party involved in securitization.

As a means of enhancing internal credit, a senior subordinated structure is commonly used. In Japan, however, the subordinated securities are often held by the originator because, among other reasons, there are few investors who are willing to purchase them.

A large part of the risk of changes in cash flows from underlying assets can be covered by credit enhancing measures.

However, the risk of bankruptcy of the parties involved in securitization is a serious problem.

As assigned claims and receivables of a bankrupt originator are typically subject to bankruptcy proceedings, investors carry the risk of nonpayment of their principal and interest.

Therefore, it is important to check whether there is any risk in the business of any party concerned or whether the party is shielded from the risk of other parties concerned. Risks are complexly intertwined, and they are summed up in table VIII-7.

9. The Enactment of Securitization-Related Laws

The existing legal system of Japan is built around business-specific laws, and the regulatory system of financial products is vertically divided along the lines of business-specific laws.

As these laws contain many provisions regulating or banning business activities outright, it was pointed out that to spur the development of new business, such as the securitization of assets, the existing laws have to be amended, and new laws must be enacted.

As regards the securitization of assets, the Specified Claims Law was enacted as an independent law in 1993. Since the enforcement of this law, the legal infrastructure has been developed steadily.

Under and thanks to the Specified Claims Law, the liquidation and securitization of assets classified as specified claims, such as leases receivable and credit card receivables, started.

Thereafter, various laws were enacted to help the banking institutions meet the capital ratio requirements imposed by the Bank for International Settlements (BIS) and to encourage the securitization of their assets to deal with the bad loan problem that had become serious since the turn of the decade of the 1990s.
Under the Special-Purpose Company (SPC) Law and Asset Liquidation Law enacted as the revised SPC Law, structures incorporating SPVs, including specific-purpose companies (TMK) and specific-purpose trusts (SPT), may be used for securitizing specified assets designated in the provisions of the said laws (real estate, designated money claims, and beneficiary certificates issued against such assets in trust) in the form of asset-backed securities (such as senior subscription certificates, specified corporate bonds, and specified promissory notes, etc.).

Under the SPC Law, the system of disclosing an asset liquidation plan and individual liquidation projects was introduced, in addition to the disclosure requirements of the Securities and Exchange Law (the Financial Instruments and Exchange Act now).

In 1998 the Perfection Law was enacted as a law prescribing exceptions to requirements under the Civil Code for the perfection of the assignment of receivables and other properties, and it was amended in 2005.

The Civil Code provides the legal requirements for the assertion of the assignment of nominative claims (claims with named creditors) against obligors or third parties. Designated claims were transferable, but the provisions of the Civil Code had been a major hurdle standing in the way of securitizing them.

And the Perfection Law set forth simple procedures for the perfection of such interests.

The Servicer Law, enacted to account for exceptions to the provisions of the Practicing Attorney Law, allows accredited joint stock companies to provide the services of administering and collecting debts. Under the Servicer Law, a debt collection company may be established to provide a bad debt collection service without conflicts with the Practicing Attorney Law.

By amending the Equity Contribution Law, the Nonbank Bond Law conditionally lifted the ban imposed on nonbanks on the issuance of corporate bonds and CPs for the purpose of raising capital for lending operations and on ABSs.

As a result of the revision of the Securities and Exchange Law as required by the Financial System Reform Law and the enforcement of the Financial Instruments and Exchange Act, beneficiary certificates of and trust beneficiary interests in assets that are deemed eligible for securitization by the provisions of the Asset Liquidation Law and mortgage certificates under the Mortgage Securities Law are now legally considered securities.

Furthermore, pursuant to the enactment of the Investment Trust Law as revised, real estate was included in eligible assets, which paved the way for the issuance of REIT securities.

C. 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 Village) bonds)

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. 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.

b. 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).

c. 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) [財政投資融資計画], 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 [ナショナルシ団方式] or (2) Dutch auction [個別発行方式].

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]

D. 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 mid90'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]

E. Credit-Rating Agencies and 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]

F. 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.

2. Financial Instruments Business Operators, etc.’s obligation to explain.

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

a. Financial Instruments and Exchange Act (FIEA)
b. Cabinet Ordinance on Financial Instruments Business, etc.
c. Cabinet Ordinance on Disclosure of Corporate Information, etc.

Cabinet Ordinance on Definitions under Article2 of the Financial Instruments and Exchange Act (FIEA); etc.

5. (Tables for Reference)

a. Introduction of Regulation for CRAs
b. Summary of the “Guidelines for Supervision of Credit Rating Agencies” and Summary of Credit Rating Agencies Regulation

©The revised Financial Instruments and Exchange Act came into force on April 1, 2010. (The accountability of securities companies, etc. came into force on October 1, 2010)
Introduction of Regulation for CRAs

**Regulation/Supervision for CRAs**

**[Purposes of Regulation]** To ensure the following:
1. Independence of CRAs from issuers, etc. of the financial instruments that they rate, and prevention of conflicts of interest.
2. Quality and fairness in the rating process.
3. Transparency for the market participants such as investors.

**[Overview of Regulation]**

- **Duty of good faith**
- **Information disclosure**
- **Establishment of control systems**
- **Prohibited Acts**

- "Inspection/Supervision, etc.
  Submission of periodic business reports, supervisory order for production of reports and onsite inspection, order to improve business operations, etc.

**Regulation/Supervision for CRAs**

- **Register CRAs with established control systems: credit rating service providers**
- **CRA**

**IOSCO Code of Conduct**

1. Quality and integrity of the rating process
   - Quality of the rating process
   - Monitoring and Updating
   - Integrity of the Rating Process
2. Independence and avoidance of conflicts of interest
   - Procedures and Policies
   - Analysis and Employee Independence
3. Responsibilities to the investing public and issuers
   - Transparency and Timeliness of Ratings Disclosure
   - Treatment of Confidential Information
4. Disclosure of the code of conduct and communication with market participants

**Financial Instruments Business Operators, etc.'s obligation to explain**

- Soliciting customer. Financial instruments business operators, etc. shall not use the credit ratings provided by unregistered CRAs.
- The fact that those CRAs are not registered and b) the significance and limitations of credit ratings.

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**Summary of the Cabinet Office Ordinance**

**Requirements for establishment of control systems**

- **Quality control of the rating process**
  1. Ensuring sufficient staff with expertise and skills.
  2. Ensuring the quality of information to be used for ratings.
  3. Resolving and updating determined credit ratings, etc.

- **Ensuring of independence and fairness**
  Requiring ratings to be determined by the rating committee and the committee members to be named, etc.

- **Prevention of conflicts of interest**
  1. Specifying acts with conflicts of interest, prevent them and publish measures to prevent them.
  2. Reversing the past credit ratings of an entity determined by an analyst who became employed at that entity, etc.

- **Credit rating determination policies, etc.**
  Additional requirements include: compliance with laws and regulations, management and maintenance of information confidentiality, responding to comments, compliance with the rating determination policies, etc.

- **Credit rating provision policies, etc.**
  Determination of the credit rating provision policies, etc.

**Explanatory documents (if any)**

- Information related to the history and details of the determined credit ratings, etc. of the development of operational control processes (making them available to the public every year)

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**IOSCO Code of Conduct**
Summary of the "Guidelines for Supervision of Credit Rating Agencies"
G. 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 (PO) and [2] a private placement (PP) of securities very clearly, irrespective of whether they are domestic or foreign.

1. Public Offering (PO)

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:

a. to a small number of investors (the SN-PP) or
b. to qualified institutional investors (the QII-PP) or
c. to specified investors (the Offer to SI)

2. Private Placement (PP)

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:

a. 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.

b. 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.

c. 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 - 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.

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.

4. Exemptions for Already-issued Securities

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 a part of Corporate Bonds, Asset backed bonds and Nonresident bonds are subject to disclosure requirements under Financial Instruments and Exchange Act of Japan (FIEA).

Government bonds and Public bonds etc. 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.

H. Definition of the Specified (Professional) Investor

1. Breakdown of the Specified (Professional) Investor

The following categories are specified investors.

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

b. The State (Japan);

c. The Bank of Japan; and

d. 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)).

e. 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.

2. Creation of the new market for Specified (Professional) Investor

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).

I. 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.1

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) 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

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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.2

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).
a. 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.

i. The TOKYO PRO-BOND Market will be a Specified Financial Instruments Market as prescribed in Article 2, Paragraph 32 of the FIEA.

ii. 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.

b. Initial Listing Application

i. 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.

ii. 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.

iii. 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.

c. 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:

a. 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.

b. 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.

d. 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.

3. Obligations after Listing

a. Timely Disclosure

i. 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

ii. 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.

4. Delisting, etc.

a. Delisting other than by Application

i. 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.

ii. 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.

5. Listing Fees

i. 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.

J. Trading System, Settlement and Clearance System

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.

a. Form of Orders

The Exchange will accept ask and bid orders from Trading Participants.

b. 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.

c. Types of Transactions

The types of transactions shall be Regular Transactions.
d. 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.

e. 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.

f. Trading Unit

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

g. 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.

h. 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.

i. 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.

j. 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.

a. Clearing and settlement of foreign-currency-denominated securities will be dealt with by the trading value TOKYO PRO-BOND Market converted into yen.

b. 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.

c. 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.

K. 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.

2. Commissioned company for bondholders System

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:

a. The fee the trustee bank had been collecting was renamed “commissioned companies fee,”;
b. 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

c. 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,

(4) 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;

(5) 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

(6) 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]

L. 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 be 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").

a. 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);

b. 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

c. 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 Solicitation, etc., of Sale and Purchase Transactions of Domestic CPs etc., and Private Placement 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
2. Guidelines

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.

M. 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 Proceeding
   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.
II. Disclosure Requirements

A. 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.

B. 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.

C. 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).

D. 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.

A. Disclosure of information concerning Corporations

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

B. 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)

C. 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)

E. 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.

F. 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.
III. Trading of Bonds

A. Overview

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: The Scale of Bond Purchasing and Selling

<table>
<thead>
<tr>
<th>Fiscal year</th>
<th>Over the counter (trillions of yen, %)</th>
<th>Exchange (trillions of yen, %)</th>
<th>Total (trillions of yen, %)</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>157 (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>
</tr>
<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: The Value of Purchasing and Selling, by Type of Bond

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

B. 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: 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>City (commercial) banks</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>Regional banks</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>Trust banks</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>Agriculture-related</td>
<td>1,997</td>
<td>2,051</td>
<td>2,012</td>
<td>2,698</td>
<td>1,814</td>
<td>2,665</td>
</tr>
<tr>
<td>banking institutions</td>
<td>(686)</td>
<td>(350)</td>
<td>(580)</td>
<td>(178)</td>
<td>(32)</td>
<td>(1,336)</td>
</tr>
<tr>
<td>Other banking</td>
<td>5,839</td>
<td>6,898</td>
<td>5,534</td>
<td>6,801</td>
<td>8,917</td>
<td>7,768</td>
</tr>
<tr>
<td>institutions</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>Life and property</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>casualty companies</td>
<td>(1,074)</td>
<td>(871)</td>
<td>(770)</td>
<td>(841)</td>
<td>(941)</td>
<td>(1,234)</td>
</tr>
<tr>
<td>Investment trusts</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>Public employees</td>
<td>498</td>
<td>876</td>
<td>917</td>
<td>822</td>
<td>786</td>
<td>635</td>
</tr>
<tr>
<td>mutual aid associations</td>
<td>(−25)</td>
<td>(571)</td>
<td>(591)</td>
<td>(564)</td>
<td>(611)</td>
<td>(459)</td>
</tr>
<tr>
<td>Business corporations</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>(960)</td>
<td>(886)</td>
</tr>
<tr>
<td>Nonresident investors</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>Others</td>
<td>22,403</td>
<td>47,589</td>
<td>42,409</td>
<td>45,763</td>
<td>44,845</td>
<td>45,856</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>Bond dealers</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>Total</td>
<td>206,892</td>
<td>293,559</td>
<td>280,468</td>
<td>308,814</td>
<td>347,880</td>
<td>326,109</td>
</tr>
<tr>
<td>(including other investors)</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 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.
C. OTC Trading of Bonds

The majority of bond transactions take place over the counter (OTC) rather than on exchanges because secondary market is 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.

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: Bond Trading by Market

<table>
<thead>
<tr>
<th></th>
<th>Exchange</th>
<th>OTC</th>
<th>Others</th>
</tr>
</thead>
<tbody>
<tr>
<td>FY2004</td>
<td>0</td>
<td>174</td>
<td>0</td>
</tr>
<tr>
<td></td>
<td>631,740</td>
<td>225</td>
<td>31,490</td>
</tr>
<tr>
<td>FY2005</td>
<td>0</td>
<td>134</td>
<td>0</td>
</tr>
<tr>
<td></td>
<td>690,063</td>
<td>146</td>
<td>32,171</td>
</tr>
<tr>
<td>FY2006</td>
<td>0</td>
<td>107</td>
<td>0</td>
</tr>
<tr>
<td></td>
<td>956,614</td>
<td>118</td>
<td>24,097</td>
</tr>
<tr>
<td>FY2007</td>
<td>0</td>
<td>62</td>
<td>0</td>
</tr>
<tr>
<td></td>
<td>1,232,317</td>
<td>62</td>
<td>21,059</td>
</tr>
<tr>
<td>FY2008</td>
<td>0</td>
<td>60</td>
<td>0</td>
</tr>
<tr>
<td></td>
<td>1,036,070</td>
<td>72</td>
<td>15,042</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: 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>Band debentures (interest bearing and discount)</th>
</tr>
</thead>
<tbody>
<tr>
<td>End of FY2000</td>
<td>266</td>
<td>728</td>
<td>504</td>
<td>2,807</td>
<td>711</td>
</tr>
<tr>
<td>Number of issues</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Outstanding balance</td>
<td>367</td>
<td>16</td>
<td>35</td>
<td>50</td>
<td>10</td>
</tr>
<tr>
<td>End of FY2004</td>
<td>313</td>
<td>1,166</td>
<td>807</td>
<td>2,614</td>
<td>159</td>
</tr>
<tr>
<td>Number of issues</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Outstanding balance</td>
<td>620</td>
<td>27</td>
<td>47</td>
<td>52</td>
<td>2</td>
</tr>
<tr>
<td>End of FY2005</td>
<td>332</td>
<td>1,386</td>
<td>925</td>
<td>2,560</td>
<td>110</td>
</tr>
<tr>
<td>Number of issues</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Outstanding balance</td>
<td>666</td>
<td>31</td>
<td>53</td>
<td>52</td>
<td>1</td>
</tr>
<tr>
<td>End of FY2006</td>
<td>357</td>
<td>1,620</td>
<td>1,005</td>
<td>2,500</td>
<td>96</td>
</tr>
<tr>
<td>Number of issues</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Outstanding balance</td>
<td>670</td>
<td>34</td>
<td>54</td>
<td>51</td>
<td>1</td>
</tr>
<tr>
<td>End of FY2007</td>
<td>372</td>
<td>1,836</td>
<td>1,108</td>
<td>2,561</td>
<td>84</td>
</tr>
<tr>
<td>Number of issues</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Outstanding balance</td>
<td>681</td>
<td>37</td>
<td>55</td>
<td>54</td>
<td>1</td>
</tr>
<tr>
<td>End of FY2008</td>
<td>396</td>
<td>2,010</td>
<td>1,200</td>
<td>2,489</td>
<td>55</td>
</tr>
<tr>
<td>Number of issues</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Outstanding balance</td>
<td>676</td>
<td>40</td>
<td>58</td>
<td>56</td>
<td>1</td>
</tr>
</tbody>
</table>

Note: Outstanding balance figures are in trillions of yen.
Source: The Japan Securities Dealers Association.

D. Bond market infrastructure diagram and Business Process Flowchart

<table>
<thead>
<tr>
<th>Trading</th>
<th>Tokyo OTC market</th>
<th>TSE</th>
</tr>
</thead>
<tbody>
<tr>
<td>Trade matching</td>
<td>JASDEC PSMS</td>
<td>JGBCC</td>
</tr>
<tr>
<td>CCP</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Settlement match.</td>
<td>JASDEC PSMS</td>
<td>BOJ</td>
</tr>
<tr>
<td>Bond settlement</td>
<td>JASDEC Book-Entry Transfer System Municipal bond, Corp. bond, etc.</td>
<td>BOJ</td>
</tr>
<tr>
<td>Cash settlement</td>
<td>BOJ BOJ-Net Funds Transfer System</td>
<td></td>
</tr>
</tbody>
</table>

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TSE: Tokyo Stock Exchange,
OTC: Over the Counter,
PSMS: Pre-Settlement Matching System,
JGBCC: Japanese Government Bond Clearing Corporation,
JSICC: Japan Securities Clearing Corporation,
JASDEC: Japan Securities Depository Center, Inc.,
JGB: Japanese Government Bond,
BOJ: Bank of Japan.
Note: Non fixed income bonds such as convertible bonds are not included here.

Business Process Flowchart: Japanese JGB Market/ DVP with Matching and CCP
E. 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

a. 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.

b. 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.

c. 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:

3. 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).

4. 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

   i. Publicize the name of the designated reporting members;

   ii. The designated reporting members shall be Association members who are capable of executing the transaction;

   iii. Others

b. Putting off the reporting deadline
i. 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.

F. 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 / auction conditions. (That is so called, “Partial price competitive tendering system.”)

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.

G. 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.

   a. 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.

b. 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.

c. 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.

H. 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.

I. 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).

a. IDB 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. **B-to-C market:**

**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.

c. **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 wants 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.

d. 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

a. Market Price Trading Method = use current prices and quotes on the stock exchanges
b. Direct Negotiation Method = use a price negotiated between customers
c. Order Matching Method = orders from customers are matched with each other
d. Quote Driven Method = market makers show their quotes and stand ready to trade with customers
e. Auction Method

For bonds PTS only (b), (c) and (d) are applicable:

b. 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.

c. 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.
d. 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
IV. Current Japanese Market Situation

A. 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 above, 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 above, 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.

B. Current Conditions of the Japanese Corporate Bond Market

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
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.

6. 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.

7. 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.

8. 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.

C. Factors Characterizing Corporate Bond Market and its Problems

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:

a. 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.

b. 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.

c. 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.

d. 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
conducted 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.

e. 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.

f. 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.

g. 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.

h. 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.

i. 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.

j. 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.

k. 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 impede 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.

a. 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.

b. 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.

c. 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.

D. Reducing the Blackout Period & Expansion of Funding Sources

1. 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.

2. 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.

E. Inconvenience of Current Disclosure System for Public Offering

1. Many of the Japanese corporate bond issuers are having critical views that -
   a. 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.
   b. But in reality most of bonds issued have been purchased by the professional investors.
   c. On the other hand, existing private placement markets in Japan are not easy to use for issuers and investors. They have no secondary market.
   d. 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.

2. Domestic securities-related regulations for retail investors, such as legal disclosure regulations, will not apply in the new TOKYO PRO-BOND Market.

3. 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.

F. Due Diligence by Securities Companies
1. Necessity of the review of Due Diligence (underwriting examination) by securities companies in Primary Market

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

   i. 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.

   ii. 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.

   b. 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.

   c. 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:

      i. Due diligence scheme of securities companies;

      ii. Roles and handling of comfort letter;

      iii. Principles to clearly share responsibilities under the FIEA and full dissemination of them.

G. Determination Process for Corporate Bond Issuance Conditions

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

   a. 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.
b. 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.

c. 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.

H. 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. Granting of covenants and information disclosure

   a. Granting of covenants

   i. 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.

   ii. 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.

   iii. 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.
iv. 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.

v. 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.

vi. 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.

b. Disclosure of information on covenants

i. 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.

ii. 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.

iii. 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.

iv. In the United States, covenant information on corporate bonds and loans is disclosed as follows:

(1) 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).

(2) 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.
v. 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.

(1) Disclosure in an annual securities report (promotion of disclosure of covenants about default);

(2) Statutory disclosure equivalent to the current report Form 8-K in the U.S.;

(3) Timely disclosure required by securities exchanges.

2. Commissioned company for bondholders

a. Credit risk of corporation and commissioned company for bondholders

i. 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.

ii. 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.

iii. 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.

iv. 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.

v. 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.
vi. 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.

vii. 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.

b. Commissioned company for bondholders in the future

i. 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.

ii. 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.

iii. 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.

iv. 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.

iv. 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.
I. 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:

J. 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

   a. 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.

   b. 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. 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.

   b. 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.

K. 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.

3. Notes

The Japanese Ministry of Finance has approved a temporary reduction of the withholding tax applied to dividends paid to non-resident investors. The effective rate for foreign investors is 7% and for local investors 10%.

This rate reduction will last until December 31, 2011, after which the withholding tax rate applied to dividends will increase to 15% for foreign investors and 20% for local investors if a further extension of the reduction is not approved by the Diet.

L. 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.

M. 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.

N. Foreign Bonds, FX 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.

O. History of Japan’s FX policy change and Yen liberalization

The history of the relationships in the above may be explained as follows:

1971 : Nixon Shock : Dollar-gold convertibility suspended-shift of the yen to the floating
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: ① Expansion of foreign exchange reserves, yen interest rates drop due to a
decline in private-sector fund demand: a record issuance of samurai bonds.
② Lifting 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).
① Substantial easing of issuer qualifications for nonresident Euroyen bonds.
② Lifting 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.
1996: Abolishment of grade criteria for corporate bond issuance and deregulation of
bond covenants.
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.

P. Derivatives Market

1. Futures Trading

“Futures trading” refers to an agreement to buy or sell a specific amount of a commodity
or financial instrument at a particular price on a stipulated future date.

The history of futures trading is as old as that of commodities trading. However, it is
generally believed that the precursor of today’s fully developed futures market emerged
in Japan as the account-balancing trading in rice (the rice market) conducted in Osaka in
the Edo period (1603–1868).

This was a method that made it possible for parties to consummate a transaction by
organizing one-on-one negotiated transactions in such a way as to enable them to settle
the difference without delivery of the underlying commodity or financial instrument and is
considered the beginning of Japan’s futures trading.
By inheriting this tradition, stock futures were traded in the form of margin transactions on the stock exchange in Japan in prewar years.

After the war, margin transactions were prohibited by the General Headquarters (GHQ) of the Supreme Commander for the Allied Powers (SCAP) in Japan in order to curb speculative transactions, but some people claim that margin trading with individual investors had been partly revived on the stock market.

In 1972, the Chicago Mercantile Exchange started trading in currency futures.

The Chicago Board of Trade started trading in futures on fictitious bonds called benchmark issues in 1974, and the Kansas City Board of Trade started trading in stock index futures in 1982. And these types of futures trading spread to the stock exchanges of other countries around the world, including the introduction of trading in securities futures in Japan. Long-term government bond futures trading that started on the TSE in 1985 was the first financial futures trading conducted in Japan.


 Strictly speaking, futures contracts are traded on the exchange. However, while a futures contract can be assigned to a third party, a margin has to be deposited to provide against nonperformance of the contract.

A forward contract is a transaction made between parties. While it cannot be assigned to a third party, it does not require the deposit of a margin.

Transactions in currency or interest-rate futures are forward contracts often negotiated between a bank and its client, and they are called forward-exchange agreements (FXA) or forward-rate agreements (FRA).

Along with swap trading, these two types of transactions played a leading role in boosting the derivatives markets around the world in the 1990s.

2. Bond Futures Trading

Trading in securities futures (Government National Mortgage Association [GNMA] certificates) first started in 1974 in the United States. Trading in 10-year government bond futures was conducted on the Tokyo Stock Exchange in 1985—the year in which they were issued in massive amounts—which was the first financial futures trading in Japan.

In 1988, superlong-term (20-year) government bond futures (discontinued in 2002) were listed on the Tokyo Stock Exchange, and trading in U.S. Treasury bond futures—which had the largest trading volume in the world—started on the Tokyo Stock Exchange in 1989.

(The trading of treasury bond futures was suspended in Japan in 1998.)

With the trading in medium-term (5-year) government note futures that started on the Tokyo Stock Exchange in 1996, Japan had finally developed a product mix comparable to that of other countries.
Bond futures are generally traded on the basis of a fictitious issue called a benchmark issue whose price is believed to indicate the level of yield curve then prevailing.

Therefore, the price of bond futures is formed in the belief that the prices of individual bonds are above the yield curve of the benchmark issue or above a yield curve that runs parallel to it. Because a seller can choose an issue just as in a regular settlement, the seller chooses the most reasonably priced issue at that point in time, but the price of the issue to be delivered is computed by multiplying the price of the benchmark issue by a conversion factor prescribed by the exchange.

One of the characteristics of the bond futures trading conducted in Japan is that issues are traded in units with a total par value of ¥100 million ($869,000 at the rate of ¥115 to the dollar), about 10 times as large as that of other countries. (This compares with $100,000 in the case of treasury bond futures traded on the Chicago Board of Trade, or 100,000 Eurodollars in the case of BUND futures traded on the EUREX.)

This is due to the fact that in cash bond transactions, bonds whose value falls short of ¥100 million are treated as a fraction of a trading unit.

As bond futures trading is usually compared with other countries in terms of the number of contracts, futures traded in Japan tend to be underestimated.

Characteristic of the bond futures market of Japan is that it is concentrated in trading in long-term government bond futures.

This reflects the fact that the maturities of government bonds are heavily concentrated in 10-year issues, as with cash bond trading, which is not unique to the bond futures market.

Since the mid-1990s, however, the concentration of cash government bond trading on the benchmark issue, which was a phenomenon peculiar to Japan, has eased. Since the end of March 1999, the practice of designating a government bond as a benchmark issue has been discontinued, with 10-year government bond futures assuming the role played by benchmark issues. Among new products, contract for difference (CFD) futures on mini-long-term government bonds, which are one-tenth the amount of normal bonds, were listed on the Tokyo Stock Exchange from the end of March 2009, but no trading has occurred since June 2009.

3. Stock Index Futures Trading

The first stock index futures contract was listed in the United States in 1982. In Japan, the Osaka Securities Exchange started trading kabusaki 50, a futures contract for a basket of 50 stocks, in 1987.


In 1998, sector index futures contracts for three industries, electric appliances, transportation equipment, and banks, were listed on the Tokyo Stock Exchange, and High-Tech 40, Financial 25, and Consumer 40 stock index futures started to be traded on the Osaka Securities Exchange.
The Tokyo Stock Exchange launched S&P/TOPIX 150 stock index futures in 2001, while three futures contracts based, respectively, on the MSCI Japan, the FTSE Japan, and the Dow-Jones Industrial Average indices were listed on the Osaka Securities Exchange in 2002.

RN (Russell Nomura) Prime Index futures commenced trading on the Osaka Securities Exchange in 2005, followed by Nikkei 225 mini-futures (OSE) and the TOPIX mini, TOPIX Core30, and TSE REIT index futures in 2006.

Prior to all these domestic listings, the Singapore International Monetary Exchange (SIMEX, now SGX-DT) started trading in the SIMEX Nikkei 225 futures in 1986, followed by the Chicago Mercantile Exchange in 1992.

Out of many futures contracts based on a variety of Japanese stock indexes or listed on different exchanges, the OSE Nikkei 225 futures are the most actively traded, while the TOPIX futures and the SGX Nikkei 225 contracts are quite liquid, creating a rather unique situation in which there is more than one contract having good liquidity among the stock index futures of a country. Classified by the underlying index, there are contracts based on the price-weighted Nikkei 225 Index, including the OSE’s Nikkei 225 and Nikkei 225 mini-futures, while the SGX and CME both list Nikkei 225 contracts, with the latter available in Japanese yen and U.S. dollar denominations. The capitalization-weighted TOPIX and Nikkei 300 indexes have corresponding futures contracts. In terms of methods of trading, all stock index futures markets have been computerized with the exception of CME’s U.S. dollar denominated Nikkei 225 index futures. However, even those index futures are traded electronically on Globex.

Since June 1989, the last trading day falls, as is the case with the United States, one business day prior to maturity, and the final settlement price is decided on the basis of a special quotation (SQ) that is computed on the basis of the opening prices of component issues on the date of maturity. In addition to a daily closing-price limit, the stock exchanges in Japan have instituted a system temporarily suspending trading (called the circuit breaker system) applicable not to the cash market but to stock index futures trading, which gives them the power to suspend trading when stock prices fluctuate violently. This system imposes restrictions on changes in stock prices in a manner different from the circuit breaker system of the United States, which suspends both cash and futures markets at the same time.

4. Financial Futures Trading

Currency futures trading started in the United States in 1972, and Eurodollar short-term interest rate contracts were the first interbank futures listed on a U.S. exchange, in 1982. In Japan, Euroyen futures, Eurodollar short-term interest rate futures (trading was suspended in 1998), and Japanese yen-U.S. dollar currency futures (contracts were delisted in 1992) were simultaneously listed on the Tokyo International Financial Futures Exchange in 1989.

These contracts were followed by the TIFFE/TFX listings of dollar-yen futures in 1991; 1-year Euroyen futures in 1992 (trading was suspended in 1998); Euroyen LIBOR futures in 1999; 5-year and 10-year yen Swapnotes in 2003 (trading was suspended in 2007); and Exchange FOREX margin contracts (Click 365) on U.S. dollars, Euros, UK pounds, and Australian dollars in 2005.

In 2009, the TFX listed overnight (O/N) uncollateralized call rate and general collateral
Financial futures trading in the United States began with futures and futures options on commodity exchanges while European countries introduced financial futures exchanges for these products. In Japan, the market is split with bond and stock futures and futures options trading on the stock exchanges, while interbank interest rate and currency futures and options are traded on the TFX, a separate market established by some banks and securities companies.

On the TFX, trading has born concentrated from the start in yen short-term rate futures, and not many currency futures, options on yen interest rate futures (introduced in 1991), or one-year yen interest rate futures have been traded.

To increase the liquidity of these financial futures, the market-making system was introduced for dollar short-term rate futures and yen-dollar currency futures in 1990, dollar-yen currency futures in 1991, and options on yen short-term rate futures in 1992. However, their liquidity has not improved much.

Meanwhile, in April 1996 TIFFE introduced a TIFFE-SPAN (Standard Portfolio Analysis of Risk) system on the basis of which the amount of margin commensurate with the risks involved is computed. Moreover, in an effort to stimulate financial futures trading, it linked the prices of its products to those of the London International Financial Futures and Options Exchange and extended its trading hours in the same year.

It made efforts to stimulate trading by introducing the night-trading system for dollar-yen currency futures in 1997 and by extending the night-trading hours in 1998. Since 1995, however, TIFFE/TFX’s business, which had grown during the first half of the 1990s, has been decreasing on account of the extremely low interest rate climate.

5. Options Trading

Options trading refers to an agreement to trade the right to buy or sell a specific amount of a commodity or a financial instrument at a fixed price (the exercise price) within a specified period in the future.

The right to become the buyer is called a call option, and the right to become the seller is called a put option.

The history of option trading goes back to antiquity. According to Aristotle, the first known option agreement was written by Thales (ca. 620–ca. 555 BC), a Greek philosopher, on the sale of an olive press.

The Chicago Board Options Exchange (CBOE) established in 1973 is the first fully developed option market. By organizing individual deals negotiated between parties, a mechanism of cash settlement was created, as is the case with futures trading, to enable investors to participate in transactions without requiring the delivery of the underlying commodity or financial instrument.

And this was an epoch-making idea in the history of options trading.

The options trading started by the CBOE in 1973 spread to other financial products, such as currency options trading, bond options trading, and bond futures options trading, in 1982; stock index options trading in 1983; and to currency futures options trading in 1984.
And it has since spread to major financial markets worldwide. In Japan, OTC bond options trading (trading in bonds with options) was introduced in April 1989.


Listed options are traded on exchanges. While they can be assigned to a third party, the seller is required to deposit a margin with the exchange to provide against defaults on the contract.

OTC options trading is a one-on-one transaction, and it cannot be assigned to a third party, but the seller is not required to deposit a margin.

Unlike stock options and stock index options, many of the currency or interest rate options are traded with banks or securities companies on the OTC market.

6. Bond Options Trading

Treasury bond (T-bond) options trading (on the Chicago Board Options Exchange) and T-note options trading (on the American Stock Exchange) conducted simultaneously in 1982 constituted the first trading in listed bond options. And T-bond futures options were traded on the Chicago Board of Trade for the first time in 1982. In Japan, the first bond options trading was conducted on the OTC market in the name of “trading in bonds with options” in April 1989. Trading in long-term government bond futures options started in 1990, and trading in medium-term government note futures options (discontinued in 2002) started in 2000, both on the TSE.

Unlike bond futures trading, which are conducted on the basis of a benchmark issue, OTC bond options are traded on the basis of individual issues, such as government bonds, corporate bonds, or foreign bonds. Because they are traded on the OTC market, bond options agreements cannot be assigned to a third party (most of the transactions are for government bonds). As with government bond futures trading, bond options are traded in units of ¥100 million ($1.1 million at the rate of ¥90 to the dollar) in par value. Because their life (from the date of contract to the date of delivery) is restricted to a maximum period of one year, and as they cannot be resold to a third party, contracts usually run a relatively long period—six months or one year.

By contrast, long-term government bond futures options are available in the form of listed American options (the option can be exercised any day during its life), and their trading mechanism is similar to that of long-term government bond futures. Whereas long-term government bond futures have only three contract months with a maximum period of nine months, long-term government bond futures options offer up to four contract months with a maximum period of six months. In addition, compared with OTC bond options, transactions in long-term government bond futures and long-term government bond futures options are concentrated in those with a short remaining life.
In Western countries where options trading have long been conducted, investors are quite familiar with the system. However, in Japan, where there is no custom of options trading, investors utilize options trading less often than futures trading. Particularly, the amount of long-term government bond futures options trading is far smaller than that of long-term government futures trading. This is because investors' interest is concentrated in outright transactions that deal only in options, and covered transactions are not made in conjunction with underlying assets (namely, long-term government bond futures). On the other hand, in conducting OTC bond options trading, investors follow the strategy of combining underlying assets with covered call or target buying.

7. Stock Index Options Trading

Trading in listed options on individual stocks started in 1973 on the Chicago Board Options Exchange (CBOE).

In 1983, the CBOE introduced S&P 100 options (the first stock index options). The Chicago Mercantile Exchange (CME) listed S&P 500 futures options (the first stock index futures options ever) and the New York Stock Exchange (NYSE) listed the New York Stock Exchange Composite Stock Index futures options in 1983.

In Japan, a series of stock index options have been listed—the Nikkei 225 stock index options on the Osaka Securities Exchange in June 1989, Options 25 on the Nagoya Stock Exchange in September of the same year (discontinued in 1998), and the TOPIX options on the Tokyo Stock Exchange in 1989.

In 1994, the Nikkei 300 stock index options were introduced on the Osaka Securities Exchange.


In Japan, listed stock index options (the Nikkei 225 options) are most actively traded on the Osaka Securities Exchange. Unlike stock index futures, other stock index options are virtually not traded in Japan. (The liquidity of the Nikkei average futures options traded on the SGX is quite low compared with that of the Nikkei average futures traded on the SGX.)

A comparison of the trading mechanisms of the Nikkei 225 options, the TOPIX options, the Nikkei 300 options, and the SGX’s Nikkei average futures options shows that while domestically traded stock index options are based on cash stock options, the Nikkei average futures options traded on the SGX are based on futures options and that the Nikkei 300 options and the SGX’s Nikkei average futures options are different in that they offer long-term options.

In addition, the trading method and the trading unit are the same as those of stock index futures. In computing the amount of margins, all exchanges have adopted the method of meeting margins in accordance with risks called Standard Portfolio Analysis of Risk (SPAN) developed by the Chicago Mercantile Exchange, and there is no significant difference among them. Among market measures, when the circuit breaker mechanism...
is tripped in stock index futures trading, options trading are also halted.

8. Securities Options Trading

Options on individual stocks listed on the Chicago Board Options Exchange in 1973 were the first call options on individual stocks. In 1977, put options were also listed on the same exchange.

While the options on individual stocks were first listed and then stock index options were listed in other countries, in Japan stock index options were introduced in 1989 first and options on 20 individual stocks (officially called equity options) were listed afterward on the Tokyo Stock Exchange and the Osaka Securities Exchange in July 1997 (seven of them were listed on both exchanges).

Since then, option trading has been extended to all listed securities along with a name change to “securities options.” As of the end of 2009, 155 issues are traded on the Tokyo Stock Exchange and 150 issues (of which 110 issues are also listed on another exchange) are traded the Osaka Securities Exchange.

Soon after the Chicago Board Options Exchange was established, the advisability of introducing securities options to Japan was considered. However, it is said that their introduction was postponed for more than 20 years for fear that they might compete with margin trading, a major source of income for small to medium-sized securities companies.

The mechanism of trading in securities options adopted by the TSE and the OSE is more or less the same. It is basically identical to that of stock index options but differs from that of stock index options trading in that the securities certificate underlying an option must be delivered to the buyer and that the final settlement price is decided on the basis of the closing price of the underlying certificate.

Although it was thought that securities options might compete with margin trading, they were not as actively traded as they were in Western countries. This is because there is no tradition of trading in options in Japan, investors are not familiar with options trading and, unlike their Western counterparts, few individual investors are interested in options trading. Options are traded in combination with their underlying assets.

In Japan, however, while capital gains earned from trading underlying equities are subject to separate taxation, those from trading securities options are subject to taxation upon total income as miscellaneous income, not to separate taxation at source.

This is believed to have discouraged individual investors from participating in securities options trading. In other countries, brokers and dealers are granted preferential treatment for their market making in relatively illiquid options.

In the similar move, the Osaka Securities Exchange and Tokyo Stock Exchange introduced the Securities Options Market-Maker Program and TSE Securities Option Supporter system, respectively. These actions, however, have not resulted in any significant increase in the trading of these options in Japan.

9. OTC Derivatives Trading

The market on which derivatives trading achieved remarkable growth around the world in the 1990s was not the exchanges but the OTC market.
Particularly, spurred by the liberalization of interest rates, the interest rate swap trading that started in 1982 has spread not only to banking institutions, but also to business corporations and has come to play the leading role on the derivatives market.

As statistics on derivatives trading conducted on the exchanges have been well kept, it is easy to follow changes occurring in their trading, but because there is no organization that keeps track of the derivatives trading conducted on the OTC market, it is extremely difficult to find out how it is doing.

To remedy the situation, the Bank for International Settlements (BIS) decided to investigate, beginning in 1995, the derivatives markets along with—and on the occasion of—the triennial investigation of the foreign exchange markets to grasp the state of trading in derivatives on the OTC market worldwide.

According to the findings of a survey conducted in April 2007, the daily average notional value of OTC derivatives traded in Japan was $88.2 billion, representing an increase of 124% from the figure in the previous survey in April 2004 (the results compare against a daily global total of $2.09 trillion and an increase of 71%).

By contract type, OTC derivatives are broken down to 55.7% in interest rate swaps (an increase of 123% from the 2004 survey); 27.1% in interest rate options (an increase of 180%); 12.2% in currency options (an increase of 43%); 3.9% in forward-rate agreements (FRA) (an increase of 870%); and 1.2% in currency swaps (an increase of 7%).

The total notional value of the outstanding OTC derivatives contracts of financial institutions in Japan as of the end of June 2007 stood at $25.4 trillion, up 44% from June 2004, relative to the total of $516.4 trillion and a 135% increase worldwide.

The breakdown of the total by contract type was 72.7% in interest rate swaps (compared with 78.0% in the 2004 survey); 8.2% in interest rate options (vs. 4.1% previously); 7.1% in foreign exchange forwards and swaps (vs. 8.2%); 2.8% in currency swaps (vs. 3.2%); 1.6% in FRAs (vs. 3.3%).

By underlying instrument, credit, equity, commodity, foreign exchange, and interest rate derivative contracts increased 937%, 183%, 109%, 43%, and 39%, respectively.

Meanwhile, the JSDA has been publishing the current state of OTC derivatives trading on a semiannual basis since the second half of fiscal 1999.

These statistics divide OTC derivatives transactions into two categories: those conducted by securities companies for their own accounts (the state of principal trading) and those between clients brokered by securities companies (the state of agency trading).

The former shows the number and total value of transactions and the ending balance of contracts in each term, while the latter shows the number and total value of transactions. The data is further divided into forward transactions in securities, forward transactions in OTC securities indexes and others, OTC options transactions in securities, and swap transactions in OTC securities indexes and others.

OTC options transactions do not include bond options transactions.
10. Credit Derivatives Trading

“Credit derivatives trading” refers to trading in credit risks involved in loans and corporate bonds in the form of swaps and options. While conventional derivatives trading bought or sold market risks, credit derivatives trading deals in credit risks.

Credit risks trading may be characterized as trading in guarantees in that it not only deals in guarantees against default but also provides a variety of products that cover the risk of declining creditworthiness caused by a deterioration of business performance.

Credit derivatives are traded largely in three typical types: credit default swaps (CDS), total return swaps (TRS), and credit-linked notes (CLN).

A CDS is a type of options trading that guarantees the credit risks involved in a loan, and when the borrower defaults on a loan underlying the CDS the damage caused by such default is guaranteed.

A CDS derives its name from the form in which the payment of a premium is swapped.

A TRS is a deal that swaps the total profit or loss (coupon and evaluated profit or loss) with the market rate, and it is used when the holder of a credit cannot sell it. And a CLN is a deal that links credit risks to a bond issued by the issuer of the underlying notes.

Therefore, it may be said that a CLN is a CDS based on a bond instead of a guarantee.

A CLN is redeemed in full on maturity unless the company designated in the contract defaults on its obligations, but when the company defaults the CLN is redeemed at a reduced value prior to maturity. While a CDS is concluded under the assumption that the guaranteeing company has an adequate capacity to guarantee, a CLN is guaranteed by the purchase of a bond.

Therefore, a CLN can be concluded regardless of the credit standing of the investor.

According to the data published by the Bank of Japan, the total notional value of outstanding credit derivatives in Japan has been accelerating in growth since 2003, multiplying by a factor of 64 from the end of December 2002 to the end of June 2009.

However, the total notional value only amounted to $275.2 billion, or a very small part of the global total of $51 trillion according to the June 30, 2007, estimates published by the BIS, but its rapid growth is expected to continue in coming years.

At the time, the BIS statistics indicated that CDS trading accounted for 88% of outstanding credit derivatives, while the BOJ statistics showed that CDS trading accounted for 99% of the outstanding credit derivatives traded in Japan.

Since recent statistics by the U.S. Office of the Comptroller of the Currency (OCC) put this figure at 98% in the United States, implying that credit derivatives transactions are being concentrated in CDS trading.
V. Securities Settlement Infrastructure

A. Legal definition of debt instruments

1. Existence of uniform legal framework for all types of securities
   a. “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.
   b. 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
   a. As described above, according to this law and the above system for securities to be distributed, it has realized the complete dematerialization.
   b. 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
   a. In the Book-Entry Transfer institutions, the securities companies and financial institutions, as "Account Management Institution" to open an account for securities transfer.
   b. In the transfer account, the balance of the own account and the overall customer account are recorded respectively.
   c. 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.
   d. In other words, the presence of the recording consists of a proof of a "Perfection third party to the issuers."
   e. 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.

B. Securities settlement infrastructure

1. Existence of CSD and Book entry system for debt instruments
   a. JASDEC (Japan Securities Depository Center, Inc.) act as CSD, provide Book-Entry Transfer System for Corporate Bonds, etc.
   b. BOJ (Bank of Japan) act as CSD, and provide Book-Entry Transfer System for JGB.
2. 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.

*Quotation from JASDEC HP.*
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.

3. Eligible Securities of Book-Entry Transfer System for Corporate Bonds

a. Corporate bonds
b. Municipal bonds
c. Investment company bonds
d. Corporate bonds issued by mutual companies prescribed in the Insurance Business Act
e. Specified corporate bonds prescribed in the “Law Concerning Liquidation of Assets”
f. Rights that should be represented by bond certificates issued by companies under special law
g. Rights that should be represented by bond certificates issued by any government or by companies in foreign countries, such as Samurai Bonds.

4. Existence of DVP and RTGS mechanism

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

b. DVP mechanism

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

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.
5. Existence of post-trade matching mechanism

*Quotation from JASDEC HP.
JASDEC provide PSMS (Pre-Settlement Matching System) for Book-Entry Transfer System for Corporate Bonds (See Number 2 and 3 in above Fig.)

6. 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.

7. 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.

8. 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.

C. Challenges / Expected changes

1. Issues on current settlement infrastructures

There are Lack of Liquidity provisioning mechanism, and Liquidity-Saving mechanism on the current JASDEC’s Book-Entry System for Corporate Bonds.

2. Expected changes on settlement infrastructures

a. CCP (Central Counter Party) is expected Reduction of settlement Risk and providing netting facilities.

b. The realization of Liquidity-Saving mechanism with the Next Generation RTGS of the BOJ-NET is expected.

D. 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 by 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, 1991.

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).

a. 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.

b. 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 settlement 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.

7. 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.
VI. Fees and Costs

(This part not yet finalized)

<table>
<thead>
<tr>
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<tr>
<td><strong>Stamp Duty</strong></td>
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<td>The buyer pays a stamp duty of JPY200 per trade for physical certificate transfers. JASDEC-held securities are exempt from stamp duty.</td>
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<table>
<thead>
<tr>
<th>Registration Costs</th>
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<td>Registrars do not charge to register equity share certificates, but may pass on their agents’ costs in terms of transporting and processing the registration documents. For bonds other than JGBs, registrars charge JPY800 to JPY1200 for registration per transaction.</td>
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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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<table>
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<th>CCB (Commissioned Company (Bond Manager) for Bondholders) Fee</th>
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<td>Rate</td>
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<td>1bp/p.a. × Outstanding Amount</td>
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<td>A</td>
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<td>BBB</td>
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社債管理管理会社設置の場合、FA Feeに加え、期中にCCB feeが加わります。

4. Credit Rating

Credit rating fee will vary greatly depending on the target, content and the size.
VII. Present State of the Bond Issuing Market

A. Overview

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.

B. The Outstanding Amount of Bonds Issued in Japan

Source: "Compiled on the basis of JSDA and JASDEC publications"

Size of LCY Bond Market in USD

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Size of LCY Bond Market in % of GDP
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<td>17.5</td>
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<td>Jun-06</td>
<td>148.6</td>
<td>17.0</td>
<td>165.6</td>
<td>6547.67</td>
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<td>Sep-06</td>
<td>149.8</td>
<td>16.7</td>
<td>166.5</td>
<td>6405.61</td>
<td>713.58</td>
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<td>Dec-06</td>
<td>149.9</td>
<td>16.6</td>
<td>166.5</td>
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<td>7096.32</td>
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<tr>
<td>Mar-07</td>
<td>148.7</td>
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<td>Jun-07</td>
<td>147.7</td>
<td>16.5</td>
<td>164.2</td>
<td>6153.55</td>
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<td>Sep-07</td>
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<td>6639.39</td>
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<td>167.2</td>
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<td>Jun-08</td>
<td>151.4</td>
<td>17.0</td>
<td>168.4</td>
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<td>Sep-08</td>
<td>151.7</td>
<td>17.2</td>
<td>168.9</td>
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<td>826.60</td>
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<td>153.9</td>
<td>17.3</td>
<td>171.2</td>
<td>8564.36</td>
<td>963.19</td>
<td>9527.55</td>
</tr>
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</table>
C. The Value of Bonds Issued in Japan

Trading Volume


<table>
<thead>
<tr>
<th>Year</th>
<th>Govt Bonds (in USD billions)</th>
<th>Corp Bonds (in USD billions)</th>
<th>Total (in USD billions)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Mar-99</td>
<td>2934.45</td>
<td>65.06</td>
<td>2999.51</td>
</tr>
<tr>
<td>Jun-99</td>
<td>4448.98</td>
<td>58.39</td>
<td>4507.37</td>
</tr>
<tr>
<td>Sep-99</td>
<td>4979.03</td>
<td>69.43</td>
<td>5048.46</td>
</tr>
<tr>
<td>Dec-99</td>
<td>4492.24</td>
<td>67.82</td>
<td>4560.06</td>
</tr>
<tr>
<td>Mar-00</td>
<td>4306.39</td>
<td>88.56</td>
<td>4394.95</td>
</tr>
<tr>
<td>Jun-00</td>
<td>4824.48</td>
<td>106.83</td>
<td>4931.31</td>
</tr>
<tr>
<td>Sep-00</td>
<td>4417.15</td>
<td>105.14</td>
<td>4522.29</td>
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<tr>
<td>Dec-00</td>
<td>4704.77</td>
<td>100.88</td>
<td>4805.65</td>
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<tr>
<td>Mar-01</td>
<td>3801.78</td>
<td>111.31</td>
<td>3913.09</td>
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<tr>
<td>Jun-01</td>
<td>4292.83</td>
<td>109.15</td>
<td>4401.98</td>
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<td>Sep-01</td>
<td>4096.92</td>
<td>95.11</td>
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<td>Dec-01</td>
<td>3399.44</td>
<td>122.50</td>
<td>3521.94</td>
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<td>3848.96</td>
<td>127.63</td>
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<td>Dec-02</td>
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<td>Mar-03</td>
<td>4228.12</td>
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<tr>
<td>Jun-03</td>
<td>5348.85</td>
<td>138.46</td>
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<td>Sep-03</td>
<td>6161.63</td>
<td>150.66</td>
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<td>Dec-03</td>
<td>6010.11</td>
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<td>Dec-04</td>
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<td>7107.04</td>
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<td>Jun-05</td>
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<td>7494.91</td>
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<td>Sep-05</td>
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<td>145.11</td>
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<td>11305.20</td>
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</tbody>
</table>
VIII. Islamic Finance in Japan

A. Japan’s background for introducing Islamic finance

Japan has strong economic ties with Islamic countries, particularly the Middle East oil producing countries, which are demonstrated by huge cash outflow from Japan to those countries every year. Facilitating reverse flow of investment from Islamic countries towards Japan and other Asian regions is very meaningful for balanced growth of global economy, particularly in the age of high oil price.

In 2007, a number of Japanese public and private institutions started to explore Islamic finance as one of the means to attract Islamic investors (particularly those who are awash with petrodollar) for making investment in Japan by participating in Islamic Financial Services Board (IFSB: an international standard-setting organization of Islamic finance services industry headquartered in Kuala Lumpur, Malaysia) for information gathering as shown below;

<table>
<thead>
<tr>
<th>Name</th>
<th>Nationality</th>
<th>Member Status</th>
</tr>
</thead>
<tbody>
<tr>
<td>Bank of Japan</td>
<td>Japan</td>
<td>Observer Member</td>
</tr>
<tr>
<td>Bank of Tokyo-Mitsubishi (Malaysia)</td>
<td>Malaysia</td>
<td>Observer Member</td>
</tr>
<tr>
<td>Japan Bank for International Cooperation</td>
<td>Japan</td>
<td>Observer Member</td>
</tr>
<tr>
<td>Japan Securities Dealers Association</td>
<td>Japan</td>
<td>Observer Member</td>
</tr>
<tr>
<td>Mizuho Corporate Bank</td>
<td>Japan</td>
<td>Observer Member</td>
</tr>
<tr>
<td>Nomura Asset Management Malaysia</td>
<td>Malaysia</td>
<td>Observer Member</td>
</tr>
<tr>
<td>Nomura Securities</td>
<td>Japan</td>
<td>Observer Member</td>
</tr>
<tr>
<td>Sumitomo Mitsui Banking Corporation</td>
<td>Japan</td>
<td>Observer Member</td>
</tr>
<tr>
<td></td>
<td>(8 institutions)</td>
<td></td>
</tr>
</tbody>
</table>

In terms of private transaction, in addition to the early commitment of Tokio Marine Group to the Takaful operations since the beginning of this century, a couple of Japanese companies and their overseas subsidiaries have carried out Islamic capital market transactions in overseas as follows;

1. Each Malaysian subsidiary of ION Credit Service and Toyota Financial Service issued Malaysia ringgit denominated Sukuk al Musharakah in 2007 and 2008, respectively.


3. Nomura Holdings issued the first US dollar denominated Sukuk al Ijarah (US$100 mil) in July 2010 in Malaysia based on aircraft leasing.

4. Daiwa Securities Capital Markets acted as co-lead arranger for Islamic REIT listed on SGX in November 2010, etc.....

B. Regulatory framework for Islamic Finance in general

For the time being, Japan is not equipped with the full-ranged regulatory framework for operating Islamic finance.

However, in December 2008, the Japanese banking/ insurance business regulation was relaxed to allow subsidiaries of Japanese banks/ insurance companies to provide certain Islamic finance services in such forms as Murabahah (cost-plus sale) or Ijarah (leasing) by amending the Ordinance for Enforcement of the Banking Law/ Insurance Business Law.
At present, there is not an explicit movement for Japanese banks to set up such subsidiaries in Japan except for a few cases where subsidiaries of Japanese banks are applying for the regulatory authorization required for conducting Islamic financial operations in overseas.

Consequently, the issues of Shari’ah compliance or that of supervision of market has not yet been taken up for discussion in Japan.

C. Regulatory and legal framework for Islamic Bonds (Sukuk)

1. Background towards amendment of legislation for fostering Sukuk Market in Japan

In 2010, further steps were contemplated to facilitate Sukuk issuance by Japanese domestic corporations (or other public or quasi-public entities) under the Japanese legal system.

In order to achieve the above steps, the following issues should be addressed;

a. financial regulatory issue ; and what kind of financial instrument do Sukuk fall under the existing financial regulation in Japan

b. taxation issue

How to put Sukuk issuance on an equal footing with conventional bond issuance from the aspect of

(i) withholding tax in respect of the distribution of profit to investors,

(ii) tax transparency in respect of the issuing vehicle, and

(iii) Registration tax and real estate acquisition tax in respect of the transfer of the underlying asset.

Since the latter half of 2010, the momentum within the governmental agency (Financial Services Agency (“J-FSA”)) became explicit such as:

a. Recommendation by expert advisory group within J-FSA (July 2010);

“It would be necessary to improve the tax treatment of Islamic finance by taking certain measures such as treating the dividends on Sukuk in the same manner as interests on bonds.

NB: interests on book-entry bonds paid to non-residents and foreign entities are excluded from taxation following the tax reform in 2010.

b. Policy assessment by J-FSA (August 2010);

c. Submission of the tax reform request by the J-FSA (August 2010) (“Tax Reform Request”);

d. Assessment and acceptance of the Tax Reform Request by Tax Commission (December 2010);

e. Outline of the tax reform 2011 announced by the government (December 2010) (“Tax Reform Outline 2011”) ; and
f. Action Plan for Japan’s New Growth Strategy, announced by the FSA on December 24, 2010

“The FSA will promote the development of the environment for Islamic bond issuance in Japan”

2. Outline of the prospective amendment of legislation for issuing Sukuk under Japanese law

Tax Reform Outline 2011 (in respect of Sukuk) involves bond-type beneficial interest (shasai-teki jueki-ken 「社債的受益権」) (the “Bond-type Beneficial Interest”) issued under the framework of the specific purpose trust (tokutei mokuteki shintaku 「特定目的信託」) (the “SPT”), which is established pursuant to the Act on Securitization of Assets (shisan ryudoka ho「資産流動化法」) (the “Asset Securitization Act”).

NB: The Bond-type Beneficial Interest is a certain type of beneficial interest under a SPT, for which a predetermined amount of money is distributed.

<i>Issuance scheme</i>

---

a. A Japanese Corporation and a trustee (of a SPT) enters into a trust agreement (“Trust Agreement”) whereby the Japanese Corporation transfers the ownership of an asset (such as real estate) (“Underlying Asset”) to the trustee who holds the same on trust.

b. The Japanese Corporation acquires the Bond Type Beneficial Interest pursuant to the Trust Agreement.

c. The Bond Type Beneficial Interests are sold on to investors.

d. Investors pay purchase price for the Bond Type Beneficial Interests to the Japanese corporation.

e. The Japanese corporation enters into a Ijarah lease agreement with the trustee in respect of the Underlying Asset.

f. The Japanese corporation makes periodic rental payments to the trustee under the Ijarah lease agreement.

g. The trustee makes periodic distribution of profit to the investors by way of dividends on the Bond Type Beneficial Interest.

h. At maturity, the Japanese corporation purchases the Underlying Asset at a predetermined price equivalent to the Bond Type Beneficial Interest amount then outstanding.
i. The trustee redeems the Bond Type Beneficial Interest by utilizing the purchase price received from the Japanese Corporation.

3. Recognition of Sukuk established/issued under foreign law

It has not been explicitly reported that the Sukuks issued in overseas jurisdiction have been offered in Japan. Some factors that are attributable to the above include uncertainty of tax treatment, a lack of market demands within Japan which has little Muslim population, and challenges over regulatory definitions of overseas Islamic products.

D. Type of Instruments

The current prospective amendment of the legislation is discussed on the basis of Sukuk al Ijarah.

The details of legal framework and other financial infrastructures (such as settlement system, listing, and accounting treatment, etc.) remain to be established/clarified. (However, the "TOKYO PRO-BOND Market" which plans to be inaugurated by TOKYO AIM of Tokyo Stock Exchange this year (2011) is the strong candidate venue for the listing of “Japanese Sukuk”.)

E. Tax related issues

The above-mentioned Tax Reform Outline 2011 in respect of Sukuk consists of three pillars as follows;

1. Taxation on the distribution of profit on Sukuk;

   - The distributions of profit on the book-entry Bond-type Beneficial Interest (that does not have voting right other than in relation to significant matters) payable to (i) the non-resident etc. shall be excluded from taxation, and (ii) the financial institutions etc. shall be exempted from withholding tax.

2. Tax transparency of the issuing vehicle; and

   - The conditions for deductibility of dividends paid by the SPT shall be amended, including the exclusion of the Bond Type Beneficial Interest from the requirement that more than 50 percent must be offered domestically.

3. Tax on transfer of underlying asset.

   - The re-purchase transaction of the underlying asset from SPT to the originator (settler of the SPT) shall be excluded from (i) registration license tax and (ii) real estate acquisition tax in relation to the Bond-type Beneficial Interest under the SPT.
F. Impediments for structuring Sukuk

1. Currently discussed Sukuk issue type is “Bond-type Beneficial Interest” issued by SPT under the Asset Securitization Act, which is different from the most commonly used type of trust certificates based on the “Declaration of Trust”. So, the usability of such vehicle is not well tested in the international context. And this structure inevitably leads to the “asset based” arrangement of underlying assets transaction, and not “asset backed” pure securitization.

2. Relevant infrastructures such as settlement system, listing, implementation rules, accounting treatment, etc. are not yet established.

G. Significance of Islamic finance (Islamic bonds: Sukuk) market

Only one Shariah-compliant finance deal have been reported in Japan involving *tokumei kumiai*, a statutory category of partnership established by an agreement between a business operator and an investor who invests in a specified business of the operator, in the field of real estate finance transaction.

However, the other types of Islamic Financial transactions have not yet been achieved within Japan including Islamic banking and Sukuk Issuance.

(As mentioned above, the several Japanese entities have issued Sukus in overseas markets.)
IX. Next Step → Future Direction

A. Future Direction

To be stated.

B. G-30 Compliance


<table>
<thead>
<tr>
<th>Recommendation</th>
<th>Implemented (We need confirmation)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Eliminate paper and automate communication, data capture, and enrichment</td>
<td>Yes</td>
</tr>
<tr>
<td>2. Harmonize messaging standards and communication protocols</td>
<td>Yes</td>
</tr>
<tr>
<td>3. Develop and implement reference data standards</td>
<td>Yes</td>
</tr>
<tr>
<td>4. Synchronize timing between different clearing and settlement systems and associated payment and foreign exchange systems</td>
<td>Yes</td>
</tr>
<tr>
<td>5. Automate and standardize institutional trade matching</td>
<td>(Yes)</td>
</tr>
<tr>
<td>6. Expand the use of central counterparties</td>
<td>(Yes)</td>
</tr>
<tr>
<td>7. Permit securities lending and borrowing to expedite settlement</td>
<td>Yes</td>
</tr>
<tr>
<td>8. Automate and standardize asset servicing processes, including corporate actions, tax relief arrangements, and restrictions on foreign ownership</td>
<td>Yes</td>
</tr>
<tr>
<td>9. Ensure the financial integrity of providers of clearing and settlement services</td>
<td>Yes</td>
</tr>
<tr>
<td>10. Reinforce the risk management practices of users of clearing and settlement service providers</td>
<td>Yes</td>
</tr>
<tr>
<td>11. Ensure final, simultaneous transfer and availability of assets</td>
<td>Yes</td>
</tr>
<tr>
<td>12. Ensure effective business continuity and disaster recovery planning</td>
<td>Yes</td>
</tr>
<tr>
<td>13. Address the possibility of failure of a systematically important institution</td>
<td>Yes</td>
</tr>
<tr>
<td>14. Strengthen assessment of the enforceability of contracts</td>
<td>Yes</td>
</tr>
<tr>
<td>15. Advance legal certainty over rights to securities, cash, or collateral</td>
<td>Yes</td>
</tr>
<tr>
<td>16. Recognize and support improved valuation methodologies and closeout netting arrangements</td>
<td>Yes</td>
</tr>
<tr>
<td>17. Ensure appointment of appropriately experienced and senior board members (of the boards of securities clearing and settlement infrastructure providers)</td>
<td>Yes</td>
</tr>
<tr>
<td>18. Promote fair access to securities clearing and settlement networks</td>
<td>Yes</td>
</tr>
<tr>
<td>19. Ensure equitable and effective attention to stakeholder interests</td>
<td>Yes</td>
</tr>
<tr>
<td>20. Encourage consistent regulation and oversight of securities clearing and settlement service providers</td>
<td>Yes</td>
</tr>
</tbody>
</table>


<table>
<thead>
<tr>
<th>Potential barrier area</th>
<th>Current situation</th>
<th>Market Assessment Questionnaire scores</th>
<th>Overall barrier assessment</th>
</tr>
</thead>
<tbody>
<tr>
<td>Quotas</td>
<td>There are no market entrance requirements for foreign investors.</td>
<td>OK</td>
<td>OK</td>
</tr>
<tr>
<td>Investor registration</td>
<td>There are no registration requirements for foreign investors.</td>
<td>OK</td>
<td>OK</td>
</tr>
<tr>
<td>FX controls - conversion</td>
<td>The Japanese yen (JPY) is freely convertible. There are no foreign exchange restrictions. Both third-party FX and offshore FX transactions are possible.</td>
<td>OK</td>
<td>OK</td>
</tr>
<tr>
<td>FX controls - repatriation of funds</td>
<td>As above. Sale proceeds or income from investments can be freely repatriated.</td>
<td>OK</td>
<td>OK</td>
</tr>
<tr>
<td>Cash controls - credit balances</td>
<td>Foreign investors can freely open cash accounts in JPY. Credit balances are allowed.</td>
<td>OK</td>
<td>OK</td>
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<tr>
<td>Cash controls -</td>
<td>There are no restrictions on overdrafts for non-residents.</td>
<td>OK</td>
<td>OK</td>
</tr>
</tbody>
</table>

2 The G30 recommendations are taken from the Group of Thirty’s report Global Clearing and Settlement – A plan of action (Copyright © 2003 Group of Thirty) http://www.partad.ru/wrld/word/g30app1.pdf
### Market Assessment Questionnaire scores

<table>
<thead>
<tr>
<th>Potential barrier area</th>
<th>Current situation</th>
<th>Market Assessment Questionnaire scores</th>
<th>Overall barrier assessment</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Taxes</strong></td>
<td>Tax generally works well. However, extensive documentation may be required for exemptions. In particular, gaining exemption for municipal bond issues is onerous. As a result, ICSDs do not currently provide a service for these bonds. The calculation of tax requires historical information in some exceptional cases.</td>
<td>LOW</td>
<td>LOW</td>
</tr>
<tr>
<td><strong>Omnibus accounts</strong></td>
<td>Omnibus accounts are permitted.</td>
<td>OK</td>
<td>OK</td>
</tr>
<tr>
<td><strong>Settlement cycle</strong></td>
<td>The settlement cycle is T+3.</td>
<td>OK</td>
<td>OK</td>
</tr>
<tr>
<td><strong>Message formats</strong></td>
<td>JASDEC (the CSD for corporate bonds), and most local market participants, use SWIFT message formats. However, BOJ-Net (the CSD for government bonds) does not use SWIFT formats.</td>
<td>OK</td>
<td>OK</td>
</tr>
<tr>
<td><strong>Securities numbering</strong></td>
<td>ISIN codes are available for all local bond issues, and are available at the time of issue JASDEC, and most local market participants, use ISIN. However, BOJ-Net does not use ISIN.</td>
<td>OK</td>
<td>OK</td>
</tr>
<tr>
<td><strong>Matching</strong></td>
<td>There are trade matching and pre-settlement matching systems for bonds.</td>
<td>OK</td>
<td>OK</td>
</tr>
<tr>
<td><strong>Dematerialisation</strong></td>
<td>Most corporate bonds and municipal bonds are held in Japan Securities Depository Centre (JASDEC) in dematerialized form. Some physical certificates still exist.</td>
<td>LOW</td>
<td>LOW</td>
</tr>
<tr>
<td><strong>Regulatory framework</strong></td>
<td>The regulatory regime is regarded as stable and consistent and no adverse comments were received in this area.</td>
<td>-</td>
<td>OK</td>
</tr>
</tbody>
</table>
X. Examples of the recommended Expression (RE) of the Related Translations

1. Laws and ordinances
   a. (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
   d. (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
   
   e. (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)
   f. (RE) Cabinet Office Ordinance on Definitions under Article 2 of the Financial Instruments and Exchange Act = 定義府令 (teigi furei)
   g. (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)
   h. (RE) Cabinet Office Ordinance on Financial Instruments Business, etc. = 業府令 (gyoufurei)
   i. (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)

2. Disclosure Documents
   a. (RE) specified securities information = 特定証券情報 (tokutei shouken jouhou)
   b. (RE) Issuer filing information = 発行者情報 (hakkoushajouhou)
   c. Securities registration statement (SRS) = 有価証券届出書 (yuukashouken todokedesho)
3. Offering and distribution

a. (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).

b. (RE) public offering of newly-issued securities = 新発債公募 (shinpatsu sai koubo)

Especially in the context that needs to distinguish between a public offering and a secondary distribution, this term is  
used.

c. (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.

d. (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)

e. (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)

f. (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.

g. (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

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

i. (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.

j. (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.

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

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

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

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

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

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

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

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

a. (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.)

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

c. (RE) registered financial institution = 登録金融機関 (touroku kinyuukan)

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

e. (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)
Contributors:

- This guide was created by the co-operation of the ADB Consultants, the members of ABMF-J and the ABMF-J Support members in Japan.
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- Japan Securities research Institute (JSRI)
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ABMF Workplan
- Phase 1 & 2 -

Satoru Yamadera
Economist, OREI, ADB
4th ABMF meeting in Jeju
Republic of Korea
30 June – 1 July 2011

Schedule up to ABMI TF3 meeting in Oct 2011

• Market consultations:
  – PRC in April, ASEAN in May, and Republic of Korea in June
  – Workshops in Brunei Darussalam and Lao PDR on 30 May and 1 June
• June 30 - 1 July: 4th ABMF meeting in Jeju, Korea
• Aug 1: ABMF-J seminar for the Japanese institutional investors
• Sept 12-13: 5th ABMF meeting in Bali, Indonesia
  – Discussion on the first draft report
Schedule up to the December

- Sept 12-13: 5th ABMF meeting in Bali, Indonesia
- Sept 19-23: Sibos in Toronto, Canada
- Oct 20: ASEAN+3 ABMI Task Force Meeting in Korea
  - Workplan for the Phase 2
  - Nomination and reappointment of the ABMF national members and experts by the ASEAN+3 governments
- Oct 21: ASEAN+3 Bond Market conference
- Early Dec: ASEAN+3 Deputies meeting
  - Submission of the final draft
- December 2011: 6th ABMF meeting in China
  - Finalizing work plan for the Phase 2
  - Discussing idea for the Phase 2 study
- By the end of December 2011: Publication of the Report

Schedule for 1H 2012

- Dec 2011: Publication of the Report
- Mid Feb 2012 (after the Chinese New Year): 7th ABMF meeting
  - Hopefully organizing 1st ABMF public conference to disseminate our publication
  - For SF1, preparing a survey to identify differences in bond issuance program. And additional nomination and reshuffle of the members.
  - For SF2, preparing a survey to identify all transaction procedures for bond issuance, interest payment, redemption, and corporate actions
- March 2012: ABMI Task force meeting
  - First reporting of Phase 2 to TF3
- April or May 2012: 8th ABMF meeting
  - Evaluate and approve the survey questions
  - Organizing a public conference to invite non-ABMF institutions (potential issuers and investors) to polish the survey questions
- May - June: 2012: Conducting the surveys
- July – August 2012: country visits.
Schedule for 2H 2012

- **July – August 2012**: country visits
  - Consider proposals to be included in the first draft
  - For SF1, drafting a proposal for a common issuance program
  - For SF2, proposal on messaging standard harmonization
- **Sept 2012**: 9th ABMF meeting
  - Discussion on the proposals.
  - Additional survey if necessary
- **Oct 2012**: Second reporting to ABMI TF3
- **Nov 2012**: AFDM+3
- **Dec 2012**: 10th ABMF meeting
  - Reporting the draft recommendations to the members.
  - Planning the Phase 3 of ABMF

Schedule for 2013

- **Feb 2013**: 11th ABMF meeting
  - Approving the draft report to ABMI TF3
- **March 2013**: Third reporting to ABMI TF3
- **April 2013**: AFDM+3
- **April 2013**: 12th ABMF meeting
- **Early May 2013**: Recommendations to be approved by ASEAN+3 Finance Ministers
- (Early June: 12th ABMF meeting)
- **3Q 2013**: 13th ABMF meeting
  - Publication of the report in 3Q 2013.
- **Phase 3 of ABMF**