

**Minutes of the 2<sup>nd</sup> Meeting of the Promotion Meeting  
for Reform of Securities Clearing and Settlement System**

Date: Tuesday, November 18, 2003 from 10:00a.m. to 11:55a.m.

Venue: Meeting Room #1 of the JSDA

Agenda: 1.State of deliberations on the laws for dematerialization of stocks, etc.  
2.Agenda of the Promotion Meeting for Reform of Securities Clearing and Settlement System.  
3. Deliberations by JGBCC.  
4. Progress of deliberations by the JASDEC.  
5.Others  
(1) Revision of the milestones set in the report “Towards Japan Securities Settlement Systems and Infrastructure Reform”.  
(2) Global trends in the laws for securities settlement system.

**Minutes of Meeting**

Because there had been changes in committee members, the meeting was started after introductions were made.

1. State of deliberations on the laws for dematerialization of stocks, etc.

Chairman Kanda began the meeting by commenting that a bill regarding dematerialization of stocks was originally scheduled to be submitted to the latest extraordinary Diet session, but it was deferred until next session due to dissolution of the House of Representatives. Since consequence of this bill is an issue of concern for the market participants, particularly for the members of the Promotion Meeting who are engaged in practical business, and it is seen as a key to shaping the future direction of our efforts, Chairman Kanda wanted to take the opportunity to ask the officials of the authorities concerned to give an explanation within the scope of their authority. Then the officials of the Financial Services Agency and Ministry of Justice explained the present status and the points of concern for practitioners.

● Summary of explanation

- “Outline for implementation of dematerialization of physical certificates” was compiled at the plenary meeting of legislative council held on September 10, 2003, and the findings were reported to Minister of Justice. We are currently preparing drafts of a bill in accordance with this report and we intend that the bill be introduced into the Diet at the earliest possible opportunity.
- It is assumed that law regarding book-entry transfer of corporate bonds, etc., commercial law, and relevant laws are targeted for revision, and that book-entry settlement system will be implemented for various types of securities covered in Securities and Exchange law, in addition to stocks. We hope that these efforts will allow for realization of unified laws for securities settlement system.
- The amendment bill covers law regarding book-entry transfer of corporate bonds, etc. and commercial law. The law concerning central securities depository and book-entry transfer (the CSD law) is scheduled to be abrogated. Also, securities investment trust law, a law on preferred investment bonds of financial institutions established by cooperative associations, and SPC Law will be revised.
- Basically, book-entry settlement system will be implemented for various kinds of securities covered in Securities and Exchange law, always excepting the instruments which are not eligible for book-entry settlement system.
- There will be 3 categories that are not eligible for book-entry settlement system. The first type is the instruments that require physical certificates as investors’ evidence of security ownership, including promissory note CP. The second is the ones that do not have regulations on issuance of instruments, as in covered warrant and DR. The third is the products focused on static soundness more than facilitation of distribution, more specifically, the ones with which bona fide acquisition is not accepted, like subscription certificates issued by the corporations established based on a special law.
- There will be 3 types of schemes switching to a new system: conversion across the board (stocks, unit of investment securities based on securities investment trust law, preferred investment bonds based on a law on preferred investment bonds of financial institutions established by cooperative associations, and preferred investment bonds based on SPC law), accession record for book-entry transfer( e.g. warrant bonds ), and no special measures to be taken.

- I would like to request that practitioners consider the issues, maintaining the momentum behind the reforms, while we will mount an effort to prepare a draft of a bill. Also, I would like to call for the practitioners to deliberate on merits (e.g. economic effect) of dematerialization, since I believe that it will be beneficial to proclaim its merits in terms of maintenance of momentum.

- I would like to ask those involved to extend their utmost efforts in continuing to deliberate on increase of ratio of stocks deposited with the JASDEC.

- I hope that it will switch to a paperless system for so-called electrical commercial paper in the early stages, as it has formed the foundation for a paperless system in spite of some changes of business flows in the firms.

- Main opinions expressed regarding the above issue.

- I would like to know whether the CSD law will be abrogated on a given date, or it will remain valid for a certain period.

--The CSD law will be repealed on the date of administration of a new law. However, the JASDEC will have the necessary power transitionally, after the law is abrogated.

## 2. Agenda of the Promotion Meeting for Reform of Securities Clearing and Settlement System.

The Secretariat stated that it was currently investigating what approaches can be taken in the light of education regarding shift to a new system and listing up the issues to be considered, in order to facilitate transition to a paperless system for stocks, based on the developments such as questionnaires conducted after the last meeting. Then this report was approved by everyone present.

## 3. Deliberations by JGBCC.

Chairman Kanda commented that Japan Government Bond Clearing Corporation (JGBCC) was established formally on October 17, 2003. He asked that Japan Bond Trading Co., Ltd., chairing the steering committee of JGBCC, report on progress of

deliberations and its schedule, since recent developments of JGBCC are major concern to everyone present, including preparation for implementation of clearing operation. A personnel in charge then made a report of the issues.

- Summary of report

- JGBCC was set up on October 17, 2003.

(Refer to the website of Reform Promotion Center for Securities Clearing and Settlement System for further information.)

- Board members, who are from the companies served on the secretariat in the steering committee, assumed new duties as non-executive directors. We have taken up residence just temporarily, and we do not have any employees as yet. However, we intend to find an office space in the beginning of next year, and to recruit staffs, mainly loan employees, at the time of personnel reshuffle in spring.
- The steering committee, composed of all the shareholders, has taken over the decision and agenda from the organizing committee and the preparatory committee for the establishment of JGBCC, and has prepared for commencement of operations. 2 working groups, “the planning subcommittee” and “the operation subcommittee”, were established under the steering committee. The planning subcommittee has advanced deliberations, focusing on the issues concerning the outline of system such as criterion for the participants and loss share rule, and the issues on governance such as cash flow plan and organizational structure. With regard to cash flow plan, the planning subcommittee intends to run it efficiently by sorting out and reducing the costs, considering the opportunities of cooperation with the other infrastructures and outsourcing. Meanwhile, the operation subcommittee is finalizing the system requirements with system vendors, and deliberating to complete basic specifications and system specifications.
- We will focus our activities on opening of an office and increasing participation for the meanwhile. The concrete schedule is as follows: In January 2004, we will release the outline of system, and hold a briefing session targeted at recruiting the participants, followed by development of basic specifications in November, and check of its details in December. In January through February 2004, we are planning to create system specifications necessary for system development of the participants,

and publish it in March 2004.

- It will require capital increase before commencement of its operation. We are going to provide information in advance to ensure that the major market participants can partake in it at that time.
- We have set the year 2004 as the target time for launch of clearing operation, as indicated in the report (October 2002) by the Working Group for the Realization of the Establishment of a Clearing Institution for JGBs. We will decide the specific time through coordination with the entities concerned in progress of system design and overall operation test.
- Main opinions expressed regarding the above issue.
  - Our company is a member of the steering committee of JGBCC. We are committed to deliberations, as is explained earlier on. Since we are not versed in functions of clearing corporation, however, I would like to ask for the cooperation of the entities concerned such as Japan Securities Clearing Corporation (JSCC), Tokyo Stock Exchange, and the JASDEC.
  - The JASDEC will enhance the matching function of JGBCC, and develop matching systems wholly, together with the ones for corporate bond and electrical CP. I would like to express my thanks to the JASDEC as I believe that these efforts will bring us the advantages of reduced costs.
  - There may be a limit to functions of JGBCC, which we set up from scratch. Therefore I think that we need to deliberate on coordination with the other clearing corporations.
  - JSCC, a first licensed securities clearing organization under the Securities and Exchange law in Japan, started its operation in January 2003 to offer clearing service for cash transactions. We, JSCC, are scheduled to widen the scope of clearing operation in February 2004, which will very possibly result in increase of participation. We are ready to actively cooperate in setting up of a clearing organization by offering our resource, based on our past experience in preparing for commencement of operation. Also, we are going to facilitate coordination among

clearing organizations in consultation with regulatory authority, and would like to ask for support of the participants, who benefit from such coordination.

- We, the JASDEC, are seeking to offer a user-friendly system by making extensive use of matching functions and improving the level of service. We are going to ensure that its schedule will be arranged to be flexible for users, through the coordination with JGBCC.

#### 4. Progress of deliberations by the JASDEC.

Chairman Kanda requested that a representative from the JASDEC report on progress of deliberations since it has advanced the consideration on various issues. The representative then made a report of the following issues.

- Summary of report

(The DVP System for Non-exchange Transaction Deliveries)

- We have to work on the DVP system for non-exchange transaction deliveries at the next stage. We are planning to carry forward the procedures for the switchover to the new system during the Golden Week holiday in 2004, setting May 6, 2004 as the target date for its implementation, and to commence the service of DVP system for non-exchange transaction deliveries on May 17, 2004. We started the system connection tests with users this week. We have received applications for the tests from 64 firms, which are mainly our major participants: 46 securities companies, 12 trust banks, and 6 banks. These numbers are apparently small compared with that of our participating companies, 280, but these 64 applicants mostly include the firms that are active in transfer of trades for non-residents and institutional investors in need of DVP settlement system. We have advanced deliberations on liquidity, one of the key components in risk management of DVP settlement system, and have oriented discussions toward securing approximately 60 billion yen: about 15 billion yen from deposit of the participants, and 45 billion yen as credit line.
- Lamfalussy Standards were set out to ensure timely completion of daily settlements in the event of an inability to settle by the participants with the largest single net debit position, and Lamfalussy Standards plus 1 was established for managing credit and liquidity risk in the event of an inability to settle by the second participant. We will

place the limit of account payable for each company at up to 30 billion yen under the DVP system for non-exchange transaction deliveries, and it will meet Lamfalussy Standards plus 1 to establish liquidity of 60 billion yen.

- We, the JASDEC, will be committed to finalization of enhancement to system. Also, we will strive to ensure that JASDEC DVP Clearing Corporation will acquire a license as securities clearing organization to provide clearing services under the DVP settlement system, and that the DVP system for non-exchange transaction deliveries will be implemented smoothly in May 2004. I would like to ask for the understanding and cooperation in the ongoing connection tests and integrative tests to start early next year, which must be very burdensome for the users.

#### (The Pre-settlement Matching System)

- When the DVP settlement system for non-exchange transaction deliveries is implemented, it will connect matching system with book-entry system, and will introduce a scheme to settle on a DVP basis without manual process based on the details of matching, which will considerably improve STP rates. Concerning the subsequent initiative, we have conducted deliberations on specifications to offer the matching functions necessary for operation of JGBCC.
- In parallel with the above, we have advanced deliberations on specifications for government bond trading in transactions of non-residents. Additionally, we have decided on a policy to provide matching functions for corporate bonds and CPs.
- It largely depends on internal system environment of each firm how to use pre-settlement matching system. In view of this, I believe that pre-settlement matching system will be a key issue since STP rates in internal systems of individual companies will affect STP initiative across the industry.

#### (Book-entry Settlement System of Corporate Bond)

- At the end of October 2003, we drew up outline of system processing for implementation of book-entry settlement system of corporate bond based on system outline compiled in June 2003. We will work on system development according to outline of system processing in preparation for commencement of system in the second half of 2005. In the meanwhile, because functions overlap between book-entry settlement system for corporate bond and that for CP, we are planning to

utilize common system infrastructures in developing these systems.

- Book-entry settlement system for CP, whose legal systems were developed earlier than the others, was implemented on March 31, 2003. As it is a new system, however, it is not widely used under the present situation. We are going to improve the usability by adding more sophisticated functions to the systems for CP, in parallel with system development for corporate bond. Our board members and staffs are continuously working together to encourage related parties such as issuers to use the systems.

#### (Book-entry Settlement System of Investment Fund)

- In regard to investment fund, a subcommittee has conducted deliberations on coverage for handling, schemes of setting/cancellation/distribution, practical issues such as payment of dividends, and switchover to the new system for outstanding beneficiary certificates to accelerate the completion of a system outline.

#### (Dematerialization of Stocks)

- Dematerialization of stocks is one of the main issues in reform of securities clearing and settlement system. We have studied this issue in terms of both institution and system, and will begin full consideration after a law is enacted. I believe that we need to secure a national consensus in moving to a paperless system for stocks, since it has far-reaching impact on the shareholders, issuers, as well as market players. I would like to call for related parties in various sectors to extend their utmost efforts and cooperation in increasing the ratio of stocks deposited with the JASDEC ahead of the scheduled transition across the board in order to ensure the smooth conversion to a paperless system.

#### ● Main opinions expressed regarding the above issue.

- I heard that DVP book-entry settlement system for corporate bond will be developed utilizing system infrastructures in common with that for CP. It is very helpful that the JASDEC will provide a coherent infrastructure. In addition, I would like to request that the JASDEC establish a system in a manner that will expand beyond international standard, as the JASDEC will create it anew.

#### 5. Others.

(1) Revision of the milestones set in the report “Towards Japan Securities Settlement Systems and Infrastructure Reform”.

Chairman Kanda commented that the report was compiled in November 2002 to clarify the overall scheme, list up the issues to be considered, and create a reform schedule. Since some milestones in the report need to be revised again based on the reports, Chairman Kanda asked that the Secretariat explain it. The Secretariat then gave a description of key changes in the milestones.

Updated documents of the report will be posted on the website of Reform Promotion Center for Securities Clearing and Settlement System.

- Main opinions expressed regarding the above issue.
  - I would suggest that we start to deliberate on the item “issues related to shortening of settlement cycles”, which is listed as “major issues” in the report. Particularly, I assume that we should kick off deliberations on the need of T+1 settlement for JGB, given that T+1 settlement for government bond is already in place in the U.S. and the U.K. It will add to the depth of the market to convert government bond into liquidity at earliest opportunity since government bond can substitute for money, and it will lead to market revitalization to decrease settlement risk through shortening of settlement cycles.
  - I assume that increase in the operation level resulting from achievement of STP and realization of T+0 repo are prerequisite for T+1 settlement for JGB. I am certain that one of crucial environmental conditions for achieving STP is put in place, considering that JGBCC was established. I suggest that we identify the issues for implementation of T+1, including trade of non-resident, firms’ approach to system, operational flow, market practice, and ultimate needs of investors.
  - I believe that T+1 settlement that leads to mitigation of risk is critical to enhance the JGB market, and that realization of STP is essential prerequisite for achieving this initiative. I think that we should see T+1 for JGB as means rather than ends, for increase of liquidity will add to the depth of the market. Since establishment of JGBCC will add momentum to enhancement of matching function, and increase in the number of its participants will make operation smoother, I assume that it will be

meaningful to have discussions among the relevant parties regarding T+1 settlement for JGB, including the issue related to JGBCC.

- We have long discussed an issue of a reduction in the settlement cycle, and we have not changed the direction of argument. However, I believe that it is of importance to build a consensus in the debate about necessity and timing, for it is inefficient to promote the system reforms indefinitely.
- T+1 is premised on getting to STP. In this context, we have witnessed the pre-settlement matching system enhanced greatly and its use of the investors growing this year. I hope that we can promote T+1 initiative with the cooperation of all concerned, encouraging the investors to use it. Also, I would like to call for those involved to extend their utmost efforts in expanding the use of the DVP system for non-exchange trade deliveries that will be implemented in 2004.

(2) Global trends in the laws for securities settlement system.

With reference to global trends in the laws for securities settlement system, Chairman Kanda reported on developments of deliberations on “Hague Convention on the law applicable to certain rights in respect of securities held with an intermediary”, and study of European Financial Markets Lawyers Group and Position Paper that the UNIDROIT Group released in August 2003.

- Main opinions expressed regarding the above issue.
- I am engaged in global custody business. I am always explaining proactively the risk associated with global trades to the institutional investors in Japan, but I only find that they are not conscious of such risks. I would like to work with relevant parties to educate them on the risks.

Please note that this outline is provisional and may be revised.