

# Japan

## Bond Market Guide



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# I. Structure, Type, and Characteristics of the Bond Market

## A. Overview

Japan raises significant amounts from capital markets to finance government expenditures, mainly through issues of Japanese government bonds (JGBs) and financing bills, and borrowing. These funding activities are supported by a large and diverse community of domestic and overseas investors and intermediaries.

Japan offers a wide range of financial tools to meet a range of issuer and investor requirements. Aside from traditional instruments such as loans, corporate bonds, and commercial papers, securitized products are also available in Japan's credit market. Securities lending and securities financing businesses are also established. Various credit risks are pooled through these securitized products, with the value of underlying assets exceeding the risks taken by investors.

Among the major market participants in Japan's bond market are domestic and foreign securities companies that serve as dealers, brokers, traders, and underwriters in the primary and secondary markets. The local government, government agency bonds and local public corporation bonds sector are the largest issuer sectors of bonds next to JGBs in the market. Majority of JGB holders are from the public sector, commercial banks, and insurance companies.

The capital market of Japan is supervised by the Financial Services Agency (FSA). Its regulatory purpose is highlighted below. The FSA is the sole regulator for the Japanese financial industry and the domestic financial and capital market. The Securities and Exchange Surveillance Commission is FSA's enforcement arm for the securities market.

Pursuant to the Financial Instruments and Exchange Act (FIEA), the Japan Securities Dealers Association (JSDA) and seven exchanges in Japan are self-regulatory organizations that oversee and inspect day-to-day securities trading.<sup>1</sup> Market

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<sup>1</sup> The seven exchanges in Japan are as follows: Fukuoka Stock Exchange (FSE), Nagoya Stock Exchange (NSE), Osaka Securities Exchange (OSE and JASDAQ), Sapporo Stock Exchange (SSE), TOKYO AIM, Inc. (Two market places: TOKYO AIM stock market, TOKYO PRO-Bond Market), and Tokyo Stock Exchange (TSE). Bonds can be listed on TSE and TOKYO PRO-BOND Market.

surveillance is a shared responsibility of the Securities and Exchange Surveillance Commission and self-regulatory organizations. The FIEA is the fundamental law governing domestic capital market and securities and other financial instruments in Japan.

Both foreign and retail investors are allowed to trade bonds in Japan.

The Ministry of Finance (MOF) is responsible for maintaining balance in tenures or interest rates, etc. within the JGB, announcing upcoming JGB issues, and providing relevant tax policies. The Bank of Japan (BOJ) decides and implements monetary policy with the aim of maintaining price stability. In implementing monetary policy, BOJ influences the volume of money and interest rates through its operational instruments, including money market operations such as buying and selling JGBs, for the purpose of currency and monetary control. To contribute to the maintenance of the financial system's stability, BOJ conducts on-site examinations and off-site monitoring, and acts as the lender of last resort to provide liquidity as necessary. BOJ is responsible for the entire operation of Japanese government securities,<sup>2</sup> including issuance, registration, interest payment, and redemption.

## B. 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 following categories:<sup>3</sup>

1. Japanese government bonds: JGB (*koku-sai*, 国債),
2. Local governments bonds (prefectures, municipalities (cities, towns and villages)) (*chiho-sai*, 地方債),
3. Government agency bonds (*seifukankeikikan-sai*, 政府関係機関債)
  - a. Japanese government-guaranteed bond (*seifuhosho-sai*, 政府保証債)
  - b. Fiscal Investment and Loan Program (FILP)-agency bond (*zaitokikan-sai*, 財投機関債)<sup>4</sup>
  - c. Government-affiliated corporation bonds (*hikoubo-tokushu-sai*, 非公募特殊債)
4. Local public corporation bonds (*chihoukousha-sai*, 地方公社債)
5. Local governments agency bond (Japan Finance Organization for Municipalities [JFM] bond) (*chihoukoukyoudantaikinyukikou-sai*, 地方公共団体金融機構債)<sup>5</sup>

<sup>2</sup> JGS include JGB, Treasury bills (T-bills) and financing bills (FB).

<sup>3</sup> Government of Japan. Ministry of Finance. 2011. *Debt Management Report 2011 - The Government Debt Management and the State of Public Debts*. [http://www.mof.go.jp/english/jgbs/publication/debt\\_management\\_report/2011/](http://www.mof.go.jp/english/jgbs/publication/debt_management_report/2011/)

<sup>4</sup> Use of proceeds are limited to and built into FILP of the Japanese Government approved by the Diet, the Japanese parliament.

<sup>5</sup> The Japan Finance Organization for Municipalities was founded by all local governments (prefectures, cities, wards, towns, and villages).

6. Corporate bonds (*shasai*, 社債)
  - a. Straight corporate bonds, etc. (*futsu-shasai*, 普通社債等)
  - b. Asset-backed corporate bonds (*shisantanpogata-shasai*, 資産担保型社債)
  - c. Convertible bonds (*tenkan-shasai*, 轉換社債),
7. Bank debentures (*kinyu-sai*, 金融債), and
8. Nonresident bonds (foreign bonds) (*hikyojusha-sai*, 非居住者債)
  - a. Yen-denominated foreign bonds (*endate-gaisai*, 円建て外債; *samurai-sai*, サムライ債)
  - b. Asset-backed foreign bonds (*shisantampogata-hikyojusha-sai*, 資産担保型非居住者債).

Public offering of Corporate bonds, Asset-backed bonds and Non-resident bonds (as classified under 6., 7. and 8. above) are subject to disclosure requirements under the FIEA. All other bonds are exempt from FIEA disclosure requirements.

## C. Explanation of the Major Types of Bonds

### 1. Government bonds

Government bonds are the securities issued by the central government. The central government pays the bondholders interests on the securities and repays the principal amount (i.e., redemption). Interest is payable on a semiannual basis, except for short-term bonds, and the principal amount is redeemed at maturity.

The JGBs currently issued can be classified into five categories:

- a. Short-term bills (6-month and 1-year),
- b. Medium-term notes (2-year and 5-year bonds),
- c. Long-term bonds (10-year bonds) and
- d. Super long-term bonds (20-year, 30-year and 40-year bonds)
- e. JGBs for retail investors (3-year, 5-year and 10-year)

During fiscal year 2002 (ending on 31 March 2003), the government introduced the Separate Trading of Registered Interest and Principal of Securities (STRIPS) and (variable-rate) retail 10-year JGB programs.

The principal and individual interest payment components of JGBs designated by the MOF as “book-entry securities eligible to strip” has been traded as separate zero-coupon government bonds. Subsequently, the government started issuing

- a. 10-year consumer price index (CPI)-linked bonds,
- b. 5-year and three-year bonds for retail investors and
- c. 40-year fixed-rate bonds in fiscal years 2003, 2005, and 2007, respectively.

The short-term JGBs are all discount bonds, meaning that they are issued at the price lower than the face value. No interest payments are made, but at maturity the principal

amounts are redeemed at face value.<sup>6</sup> On the other hand, all medium-, long- and super long-term bonds, and JGBs for retail investors (3-year, 5-year) are bonds with fixed-rate coupons. With fixed-rate coupon-bearing bonds, the interest calculated by the coupon rate determined at the time of issuance is paid on a semiannual basis until the security matures and the principal is redeemed at face value. JGBs for retail investors (10-year floating rate) are JGBs with coupon rates that vary over time according to certain rules. The 15-year floating-rate bonds, as well as the JGBs for retail investors (10-year) feature their coupon rates that vary according to certain rules. New issuance has been put on hold for the 15-year floating-rate bonds, however.

Issuance has also been put on hold for inflation-indexed bonds, which are securities whose principal amounts are linked to the CPI as stated above. Thus, although their coupon rates are fixed, the interest payment also fluctuates.

## 2. Local Governments Bonds

Local governments and municipalities borrow funds on deeds from banks or issue debt securities in the market. Sometimes, they are called municipal debt. Those issued in the bond market are generally called “local governments bonds”. Of these, those securities that are placed with an unspecified number of investors are called “publicly offered municipal bonds.” These bonds are issued as a single entity, but some bonds are issued as a joint issue with several local governments. 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:

1. Government-guaranteed bonds that are backed by the full faith and credit of the government,
2. FILP-agency bonds that are issued by fiscal investment and loan agencies that do not enjoy such guarantee, and
3. Government-affiliated corporation bonds

The three categories of debt securities mentioned above are sometimes collectively called “public sector bonds.”

## 4. Corporate Bonds

In addition to non-financial enterprises, banks and consumer finance companies may also issue corporate bonds in accordance with the *Companies Act*.

## 5. 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

<sup>6</sup> Since February 2009, Treasury bills (6-month, 1-year) and financing bills (2-Month, 3-Month, 6-Month) have jointly been issued, under unified names of Treasury Discount Bills (abbreviation: T-Bill), in the primary and secondary market transaction. But their legal status has not changed under the existing fiscal system and they will continue to be handled as Treasury Bills and Financing Bills under the fiscal system.

principally issued in the form and maturities of 5-year interest-bearing and 1-year discounted debentures.

#### 6. Non-Resident 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.

### D. 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.” 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 Securitization Act*, intellectual property (such as copyrights and patents) also can be securitized.

#### 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 an 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.

An SPC established under the *Asset Securitization Act* (revised as the *Special-Purpose Company [SPC] Law*) (2000年改正SPC法 or 資産流動化法) is called *tokutei mokuteki kaisha* (特定目的会社: 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 or 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 (J-REIT) which are categorized in equity.

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 (住宅ローン債権信託) launched in 1973, for the purpose of handling the liquidation of mortgage loans of mortgage companies. However, this product failed to attract the attention of both issuers and investors because of too many limitations. This scheme had been regulated by the MOF and has been fully liberalized in June 1998. As the scheme based on SPC became available thereafter, as a result of the enactment of the former SPC Law in 1998 (1998旧SPC法 or 特定目的会社による特定資産の流動化に関する法律), 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.

This is not a bond but as a reference, J-REIT, which became available by virtue of implementation of the *Investment Trust and Investment Corporation Law* (投資信託及び投資法人に関する法律) 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 (asset-backed securities [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 enactment of the *Specified Claims Law* (特債法 or 特定債権法) in June 1993.

Other securitized products are called “collateralized debt obligations” (CDO), which are 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. 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. Issuing 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 JSDA and Japan Bankers Association, the total value of securitized products issued in Japan was about ¥2.6 trillion in 2010. Although securitized products issuance reached a peak of ¥9.8 trillion in 2006, levels have declined sharply over the past few years under the impact of the weakening of the economy kicked off by the subprime loan problem.

**Table 1.1 Change in Number and Value of Securitized Product Issuance Market**

	2004	2005	2006	2007	2008	2009	2010
Number of Issuance of Securitized product	296	312	314	261	204	146	107
Issuing amount of Securitized products	¥5.3 trillion	¥8.2 trillion	¥9.8 trillion	¥6.8 trillion	¥3.7 trillion	¥2.9 trillion	¥2.6 trillion
[Reference]							
Issuing amount of corporate bonds	¥5.9 trillion	¥6.9 trillion	¥6.8 trillion	¥9.4 trillion	¥9.6 trillion	¥10.3 trillion	¥9.9 trillion
Source:	JSDA and Japan Bankers Association.						

#### 5. Secondary Market for Securitized Products

With the exception of beneficiary certificates of J-REIT, trading in securitized products is not conducted in stock exchanges. This is because, as is the case with bonds, securitized products and their transactions are too complex and varied to lend themselves to exchange trading. This has led to the dependence on an over-the-counter (OTC) interdealer market for their trading.

#### 6. 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 (特債法 or 特定債権法) in 1993. Since the enforcement of this law, the legal infrastructure has been developed steadily. Under 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 SPC Law in 1998 and *Asset Securitization Act* enacted as the revised SPC Law in 2000, 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 ABSs (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 FIEA now).

In 1998 the *Perfection Law* (債権譲渡特例法) was enacted as a law prescribing exceptions to requirements under the *Civil Code* (民法) 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 in securitizing them. 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* (弁護士法), allows accredited joint stock companies to provide the services of administering and collecting debts. Under the *Servicer Law* (サービサー法 or 債権管理回収業に関する特別措置法), 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* (出資法), the *Nonbank Bond Law* (ノンバンク社債法) 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* (証券取引法) as required by the *Financial System Reform Law* (金融システム改革法) and the enforcement of the FIEA (金融商品取引法), beneficiary certificates of and trust beneficiary interests in assets that are deemed eligible for securitization by the provisions of the *Asset Securitization Act* (改正SPC法 or 資産流動化法) and mortgage certificates under the *Mortgage Securities Law* (抵当証券法) are now legally considered securities.

Furthermore, pursuant to the enactment of the *Investment Trust Law* (投資信託法) as revised, real estate was included in eligible assets, which paved the way for the issuance of J-REIT securities.



## E. Methods of Issuing Bonds Other than Corporate Bonds

### 1 Government Bonds

JGBs and other government debt securities are mainly issued as either underwritten by primary dealers (PDs, so-called participants) and re-sold to the public market or direct subscription by BOJ and other government-affiliated parties. Major volume of JGB issuance and distribution are sustained by PDs, while BOJ underwriting has given assurance of balance of supply and demand in the JGB market.

#### a. Methods of Japanese Government Bonds Issuance

Methods of JGB issuance are broadly categorized into “issuance to the market,” “issuance to retail investors,” and “issuance to the public sector”.

**Table 1.2 Methods of Japanese Government Bonds Issuance**

Methods of JGB Issuance	Explanation
A. Offering to the market	JGBs are principally issued in public offering on market-based terms of issuance.
a. Price/yield-competitive auction	<p>Price/yield-competitive auction is a method in which each auction participant submits a bidding price (or yield) and bidding amount in response to the issue terms (e.g., issue amount, maturity, coupon rate) presented by the MOF, and the issue price and amount will then be determined based on the bids.</p> <p>In this type of auction, the issuing authority starts selling first to the highest price bidder in descending order (or to the lowest yield bidder in ascending order) till the cumulative total reaches the planned issue amount.</p> <p>In Japan, the auction method varies by type of security.</p> <p>One is the conventional method by which each winning bidder purchases the security at his bidding price; and the other is the Dutch-style method by which all winning bidders pay the same lowest price of their biddings regardless of their original bid (Except for inflation-indexed bonds and 40-years bonds, offered via Dutch-style yield-competitive auction, all the JGBs are offered via the conventional price competitive auction).</p> <p>In order to increase government bond liquidity, the MOF also started implementing the immediate reopening rule effective from March 2001 issues. When a new issue is offered by the MOF, both its coupon rate and principal or interest payment dates may occasionally correspond to those of a specific issue outstanding. In such a case, the MOF reopens the outstanding issue additionally. And then, as soon as it comes into the market, the reopened issue is immediately dealt as the outstanding issue based on the immediate reopening rule.</p> <p>Also, under the new rule, a reopened issue will generate accrued interest (a 6-month interest will be paid in full to bondholders at the first interest payment even when the bondholding period during the purchase to the first interest payment will amount to less than 6 months. To make the necessary adjustment, bondholders are required to pay accrued interest at the time of purchase (i.e., the interest for the period calculated by subtracting the actual bondholding period from 6 months).</p> <p>Furthermore, in April 2006, Auctions for Enhanced-Liquidity (See b. below), in which the outstanding issues with scarce liquidity are additionally reopened, were introduced to maintain and enhance the liquidity of the secondary market.</p>
b. Non-competitive auction	<p>Besides competitive auction, 2-year, 5-year and 10-year Bonds are also issued through non-competitive auction. This approach is to take into account small and medium market participants who tend to submit a smaller bid than their larger counterparts.</p> <p>Biddings for non-competitive auction are offered at the same time as for the price-competitive auction, and the price offered equals to the weighted average accepted price of the price competitive auction.</p> <p>One can bid for either the price competitive auction or for the non-price competitive auction.</p> <p>The maximum issue amount is 10% of the planned issue amount.</p> <p>Each participant is permitted to bid up to ¥1 billion.</p>
c. Non-Price Competitive Auction I and II	<p>Non-Price Competitive Auction I is an auction in which biddings are offered at the same time as for the price-competitive auction. The maximum issuance amount is set at 10% of the total planned issue amount and the price offered is equal to the weighted average accepted price of the price competitive auction. Only the JGB Market Special Participants are eligible to bid in this auction. Each participant is allowed to bid up to the amount set based on the result of its successful bids during the preceding two quarters.</p> <p>Non-Price Competitive Auction II is an auction carried out after the competitive auction is finished. The price offered is equal to the weighted average accepted price in the price-competitive auction or lowest accepted price in Dutch-style yield-competitive auction. Only the JGB Market Special Participants are eligible to bid in this auction. Each participant is allowed to bid up to the 15% of one's total successful biddings in the competitive auction and Non-Price Competitive Auction I.</p>

*continued on next page*

Table 1.2 continuation

Methods of JGB Issuance	Explanation
	JGB are offered through above b. and c. reserved for special participants (PDS) (23 companies are designated as of October 2009).
B. Methods of selling JGBs to Retail Investors	
a. JGBs for Retail Investor	In March 2003, issuance was started on 10-year floating-rate bonds for Retail Investors in order to promote JGB ownership among individuals. Moreover, in order to respond to retail investors' different needs and to further promote sales, fixed rate 5-year and 3-year JGBs for Retail Investors were introduced. Bond features have been undergoing various improvements, again for additional sales promotion. Issuance of JGBs for Retail Investors rests on their handling and distribution during the specified application period by their handling institutions comprised of security companies, banks, and other financial institutions, as well as post offices (as of 7 March 2011, handling institutions numbered 1,102). Under this arrangement, the handling institutions are commissioned by the state to accept purchase applications and to sell JGBs to retail investors. Handling institutions are paid a commission by the state corresponding to the handled issuance amounts
b. New Over-The-Counter (OTC) sales system for selling marketable JGBs	In addition to JGBs for Retail Investors, in October 2007 a new OTC sales system for marketable JGBs was introduced in order to increase retail investor purchase opportunities with regard to JGBs (2-year, 5-year, and 10-year marketable bonds). With regard to this new OTC sales system, it allows private financial institutions to engage in subscription-based OTC sales of JGBs in a manner previously exclusive to post offices. This development allows retail investors to purchase JGBs via financial institutions with whom they are familiar, it also allows them to purchase JGBs in a manner that is essentially ongoing. As with JGBs for Retail Investors, for the new OTC sales system, the MOF has commissioned financial institutions (as of 1 March 2011, 755 institutions are conducting subscription-based sales of JGBs) to conduct subscriptions and sales of JGBs. the MOF pays subscription handling charges to these institutions based on the value (volume) of subscriptions handled by them. Note that while these financial institutions are required to subscribe and sell JGBs at prices defined by the MOF within a defined period, they are not required to purchase any unsold JGBs.

Source: Japan, Ministry of Finance website.

#### b. Auctions for Enhanced-Liquidity

The amount of auctions for enhanced-liquidity has been expanded in keeping with the striking drop in JGB market liquidity after the Lehman Shock in 2008 and the alteration of JGB Issuance Plan according to budget formulation. Specifically, the frequency of auctions was increased from the conventional one per month to two per month in October 2008, and the issuance per auction was raised in stages from ¥100 billion to ¥300 billion by July 2009. On these approaches, a discussion paper entitled “Current Situation and Future Challenges of Debt Management Policy–Discussion Paper” compiled by the Advisory Council on Government Debt Management (16 December 2009) (hereinafter referred to as the “Discussion Paper”), suggests that “the issuing authorities should identify the auctions as a supplementary measures” [sic] and that “it is desirable for the issuing authorities to consider the issuance size, frequency and target issues, upon sharing such recognition with market participants that the auction should be implemented within the supplementary function.”<sup>7</sup>

As with Fiscal Year (FY) 2010, the JGB Issuance Plan for FY2011 stipulates an issuance of ¥600 billion monthly (total amount in FY2011 is ¥7.2 trillion annually). For the first quarter of FY2011, it was described after discussions at the meeting of JGB market special participants and the meeting of JGB investors to continue monthly issuance in the amount of ¥300 billion for each of the 10- and 20-year bonds with 5 to 15 years remaining until maturity, and of the 20- and 30-year bonds with 15 to 29 years remaining until maturity.

<sup>7</sup> Government of Japan. Advisory Council on Government Debt Management. 2009. *Current Situation and Future Challenges of Debt Management Policy–Discussion Paper*. [http://warp.ndl.go.jp/info:ndljp/pid/1022127/www.mof.go.jp/english/bonds/discussion\\_paper.pdf](http://warp.ndl.go.jp/info:ndljp/pid/1022127/www.mof.go.jp/english/bonds/discussion_paper.pdf)

### c. Japanese Government Bonds Market Special Participants Scheme

Amid expectations that JGB issuance in large volumes will continue, in October 2004 the “JGB Market Special Participants Scheme” was introduced in Japan. This scheme is based on the so-called “Primary Dealer System” generally maintained in major European countries and the United States (U.S.) to facilitate secure stable consumption and to maintain and enhance the liquidity of government bond markets.<sup>8</sup> Under the scheme, the MOF grants special entitlements to certain auction participants when they carry out responsibilities essential to debt management policies. The following is an outline of the scheme:

#### i. Purpose

To promote stable financing and to maintain and improve liquidity on the JGB market, the MOF cooperates with JGB market special participants, who are key players in the JGB market and participate in planning and operating JGB management policies with special entitlements and responsibilities.

#### ii. History of Introduction of Systems

- 1) October 2004: The JGB Market Special Participants System was introduced and Special Participants were designated. The Meeting of Special Participants was also started. The Non-Price Competitive Auction II (held concurrently after normal competitive auctions) was launched.
- 2) April 2005: The Non-Price Competitive Auction I (held concurrently after normal competitive auctions) was launched.
- 3) January 2006: Interest rate swap transactions started.
- 4) March 2006: The government bond syndicate underwriting system was abolished.
- 5) April 2006: Auction for Enhanced-Liquidity was launched.

### d. Current Japanese Government Bonds Issuing Market Situation

JGB market issuance (JGBs issued through scheduled auctions from April to next March) increased by ¥0.6 trillion from FY2010 initial plan up to ¥144.9 trillion. This issuance amount increased for the third consecutive year.

JGBs issued to retail investors widely fluctuated depending on the trend of interest rate. Therefore, in the FY2011 issuance plan, considering the past sales amount, as well as revisions of the rate-setting formula for 10-year floating-rate in July 2011, issuance of JGBs to retail investors amounted ¥2.5 trillion.

JGB issuance to the public sector, while JGB issuance is made only to the BOJ, increased by ¥0.5 trillion from the FY2010 initial plan to ¥11.8 trillion.

In FY2011, with market issuance plan by JGB types reaching the historic highest of ¥144.9 trillion, the issuance covers a wide range of maturities from the short-term to the super long-term zones to eliminate distortive impacts on the market to the extent possible while taking into consideration the market trends and investor needs.

To ensure the basic objective of Debt Management Policy, stable and smooth issuance

<sup>8</sup> For details, refer to II. Framework of Debt Management. [http://www.mof.go.jp/english/jgbs/publication/debt\\_management\\_report/2011/saimu2-1-1.pdf](http://www.mof.go.jp/english/jgbs/publication/debt_management_report/2011/saimu2-1-1.pdf)

of JGBs, and minimize medium-to-long term funding cost, the issuing authorities are very much interested on whether the JGB market has sufficient liquidity to enable transactions to be conducted freely in accordance with investors' interest rate forecasts and investment strategies.

The JGB secondary market consists of brokers such as JGB market special participants (PDs) and investors. Basically, the maintenance and enhancement of liquidity should be achieved by autonomous functioning of the market, which is stimulated by active transactions among such market participants. Consequently, issuing authorities should support this autonomous functioning by arranging amounts and maturities, as well as reopen issues in the primary market.

However, the JGB market may also see a rapid fall in liquidity in times of global financial market turmoil such as that following the September 2008 Lehman Shock. In such circumstance, issuing authorities have flexibly executed auctions for enhanced-liquidity and buy-backs and measures utilized previously, and have pursued steady and smooth issuance of JGBs while providing liquidity support to the JGB market.

In the near term, amid prospects of continued JGB issuance in large volumes, to maintain the liquidity of JGB markets remains a critically important point. While a basic stance lies on the autonomous function of the market, the issuing authority views that the use of supplemental means is effective given it remains within the scope required for attaining the basic targets of JGB management policy.

## 2. Local Government Bonds

Local government bonds include prefecture bonds and municipalities (city, town, and village) bonds. Under local finance law, the concept of local government bonds exclude less than 1 year finance, and includes not only bonds but also loans. To avoid complication, hereafter loans are excluded from the 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—to borrow money provided that the 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 obtain the approval of the local assembly.
- b. The actual issuance for a prefecture and a designated city is also subject to consultation with the Minister of Internal Affairs and Communications (MIC), and issuance for an ordinary city, town and village is 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 are also joint local government bonds which are issued in the form of public offerings each month by 33 local governments under joint and several guarantees.

### 3. Government Agency Bonds

#### a. Government-Guaranteed Bonds

The issuance of government-guaranteed bonds is part of the FILP, and annual ceilings on the issue amount must be approved by the Diet. All government-guaranteed bonds are issued in the form of interest-bearing bonds with maturities ranging from 2 to 30 years. Government-guaranteed bonds are issued by way of either (1) negotiated underwriting by a so-called national syndicate or (2) Dutch auction. In the former method, the terms of issue are determined based on the average of pre-marketing results of all national syndicate members; in the latter, the terms are set through competitive bidding.

#### b. Fiscal Investment and Loan Program-Agency Bonds

FILP-agency bonds are also issued as interest-bearing bonds with maturities ranging from 5 to 10 years. In issuing them, the issuing agency usually selects a lead manager, which, in turn, forms an underwriting syndicate.<sup>9</sup>

## F. 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 a 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 conditions are electronically filed with the Local Finance Bureau of the MOF 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 yield.

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<sup>9</sup> Japan Securities Research Institute. 2010. *Securities Market in Japan 2010*. Tokyo, Japan. P.86–88. <http://www.jsri.or.jp/web/publish/market/index.html>

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

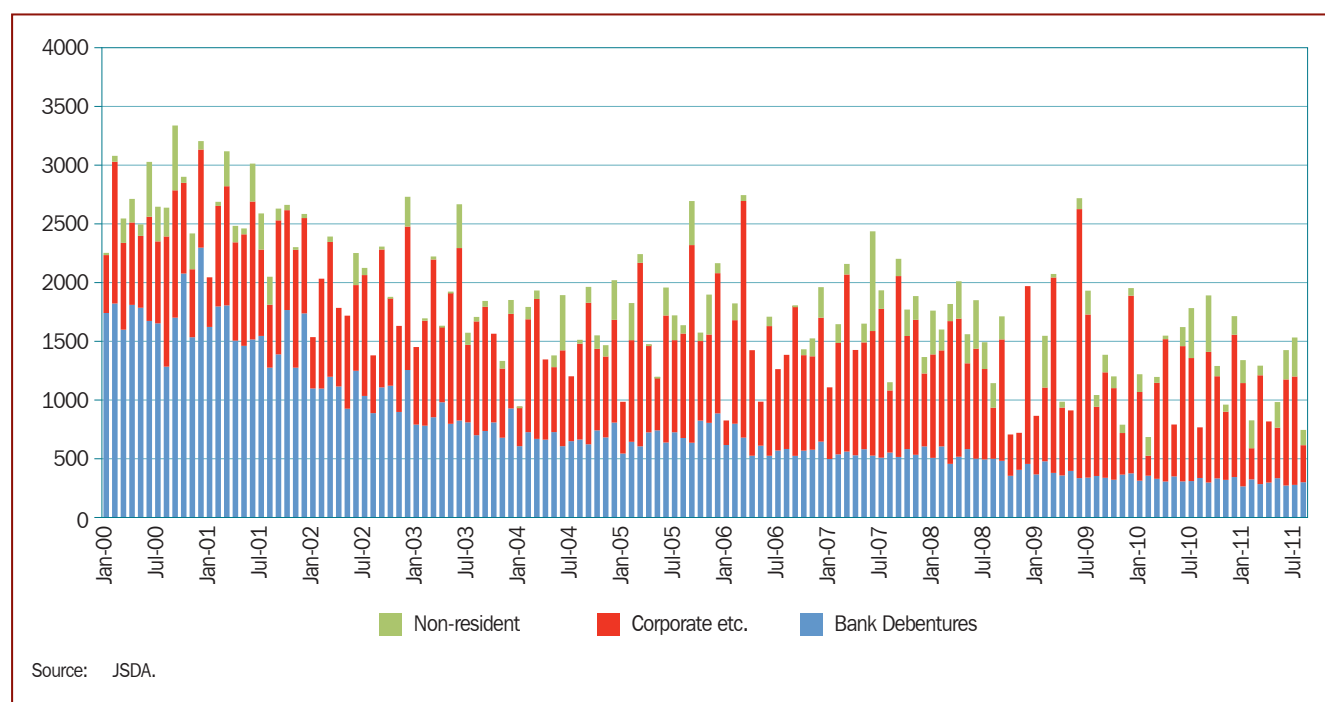
Discounted bank debentures are issued twice a month by an issue-as-reverse inquiry. Discounted bank debentures are issued by banking institutions, such as Aozora Bank (mainly former Long-term Credit Bank-related banks). Those banks are commissioning securities companies to sell them on their behalf.

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.<sup>10</sup>

## G. Credit-Rating Agencies and Credit Rating of Bonds

Credit rating was introduced in 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 eligibility standards were abolished in 1996. Nevertheless, few BBB-rated bonds, let alone junk bonds, have been offered on the market.

**Figure 1.1 Monthly Issuance of Corporate (Non-public) Sector Bonds, January 2000–August 2011 (¥ billion)**



<sup>10</sup> Footnote 9, p.88–91.

After the latest financial crisis of 2007–2008, the gradual recovery trend in corporate performances and demand from financial institutions in Japan, particularly regional financial institutions, supported a gradual recovery in the second half of 2008 and the beginning of 2009 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 U.S., and their issuance remains at low ebb.

One explanation is that backed by the prudential regulations and internal investment guidelines, most of the institutional investors in Japan are risk averse and 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 representatives, 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.<sup>11</sup>

## H. Introduction of the Register System for Credit-Rating Agencies in Japan

### 1. New Regulation System

After sub-prime loan crisis, there were huge controversies about regulation of the credit-rating agencies (CRAs). In Japan, the regulations for CRAs were introduced on 1 April 2010. Along with the new regulation system, six CRAs registered with FSA on 17 December 2010. The following are the registered CRAs in Japan:

- a. Japan Credit Rating Agency, Ltd.,
- b. Moody's Japan K.K.,
- c. Moody's SF Japan K.K.,
- d. Standard & Poor's Ratings Japan K.K.,
- e. Rating and Investment Information, Inc., and
- f. Fitch Ratings Japan Limited.

### 2. Financial Instruments Business Operators' Obligation

Since October 2010, in soliciting customers, financial instruments business operators 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 Form

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

### 4. Related Laws and Regulations

- a. *Financial Instruments and Exchange Act*

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<sup>11</sup> Footnote 9, p. 91–93

- b. Cabinet Ordinance on Financial Instruments Business
- c. Cabinet Ordinance on Disclosure of Corporate Information
- d. Cabinet Ordinance on Definitions under Art. 2 of the FIEA

### 5. Overview of Regulations and Guidelines for Credit-Rating Agencies

- a. Introduction of Regulation for CRAs

Figure 1.2 Introduction of Regulation for CRAs (I)

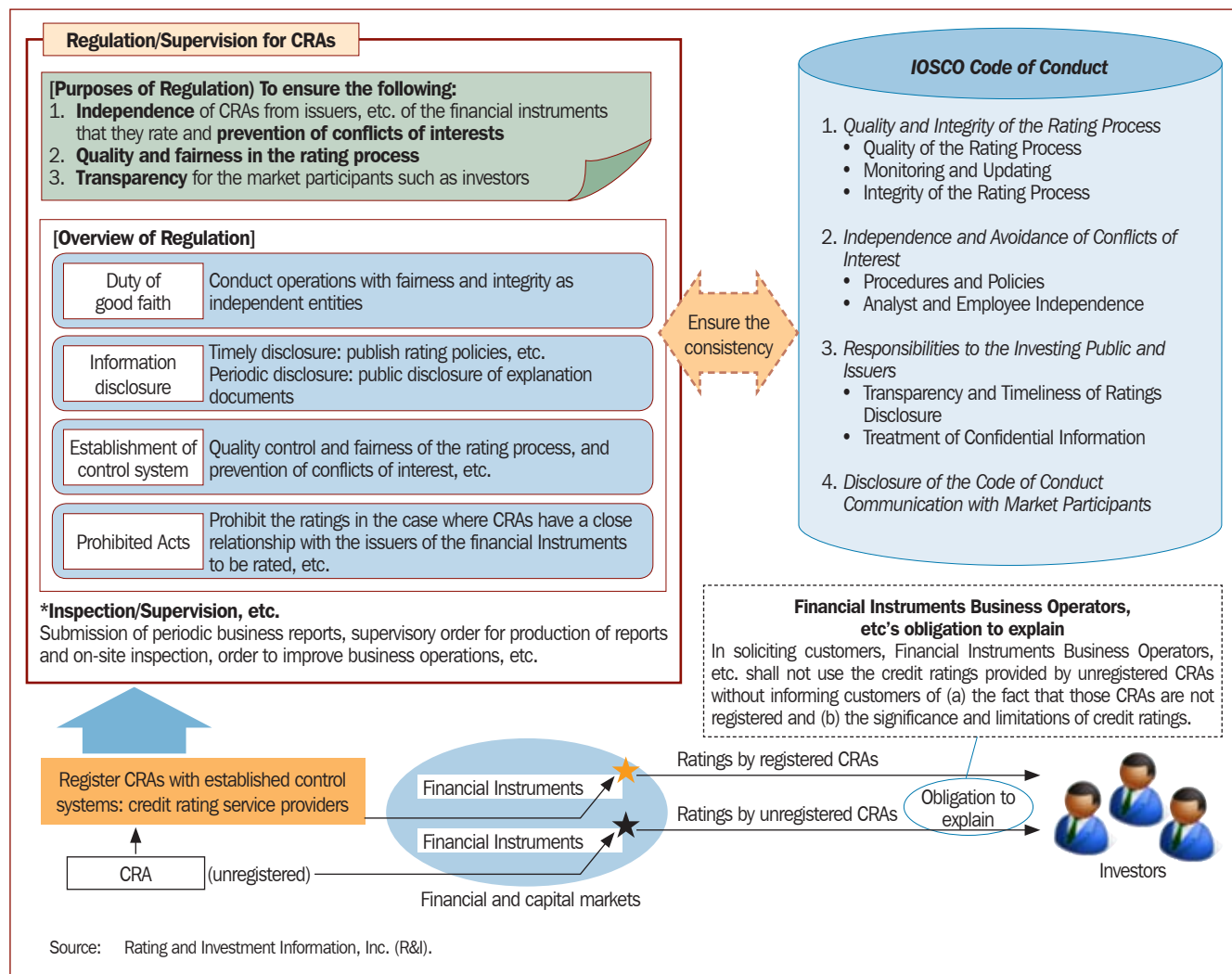
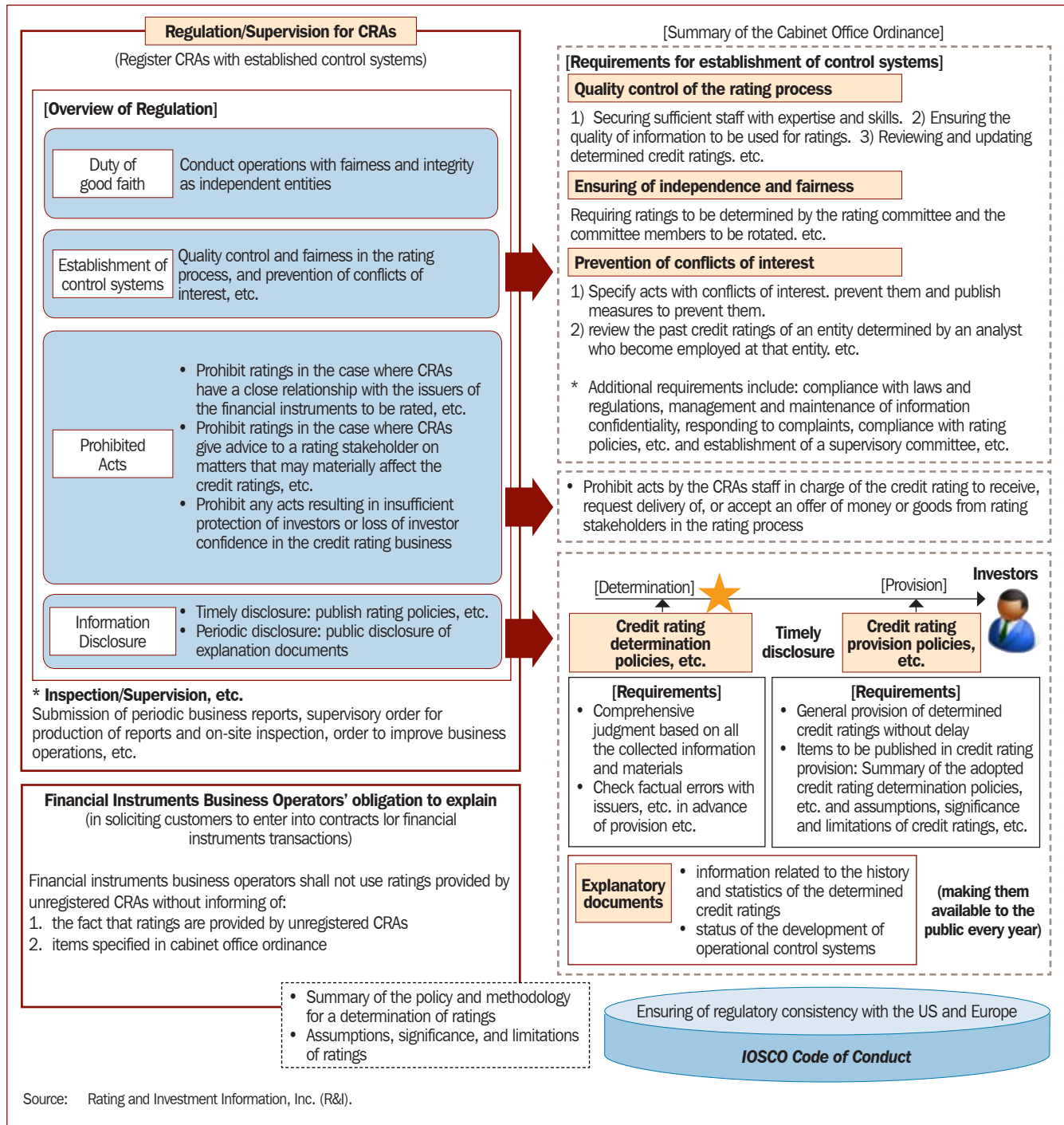




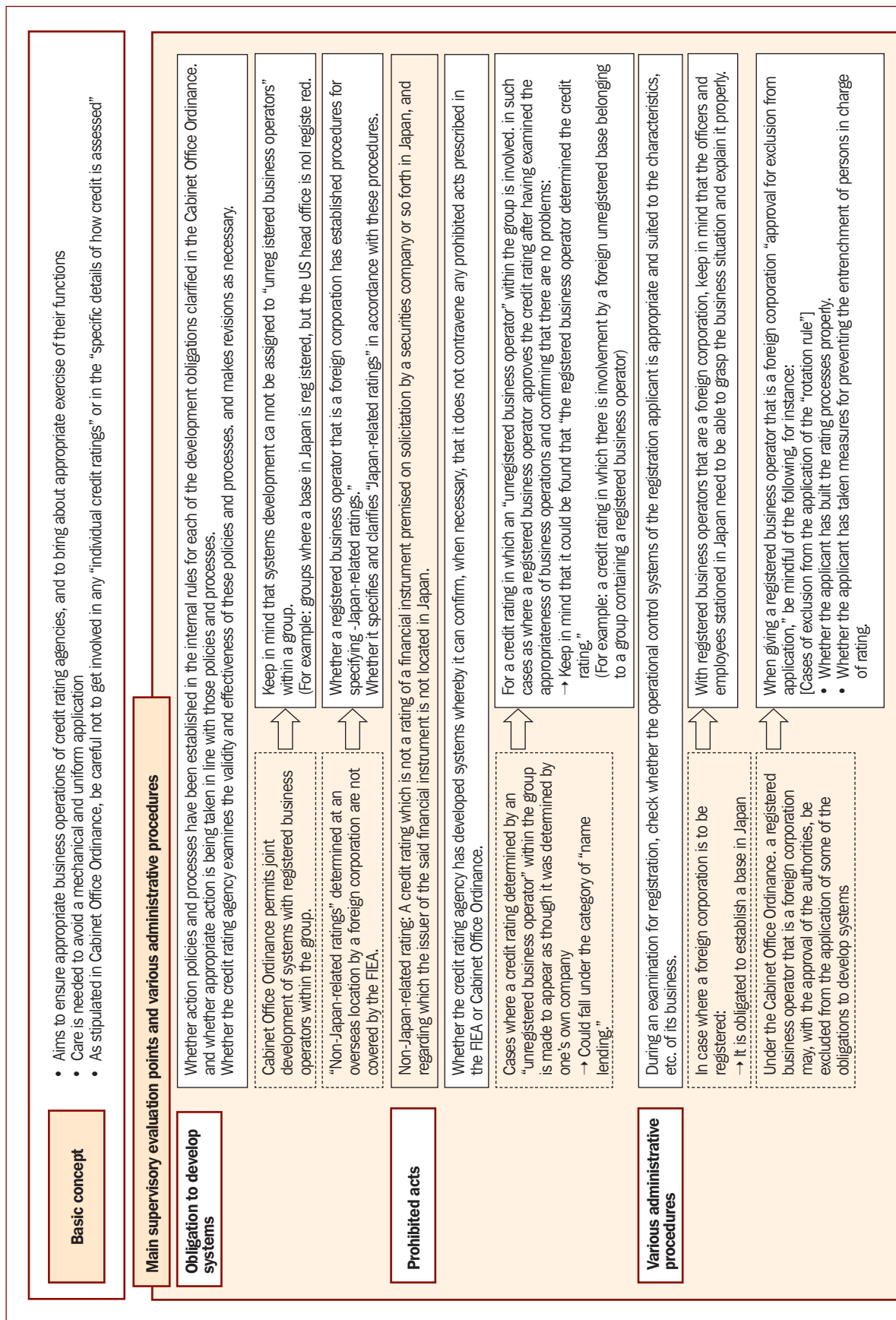
Figure 1.3 Introduction of Regulation for CRAs (II)



b. Summary of the “Guidelines for Supervision of Credit Rating Agencies” and “Summary of Credit Rating Agencies Regulation”

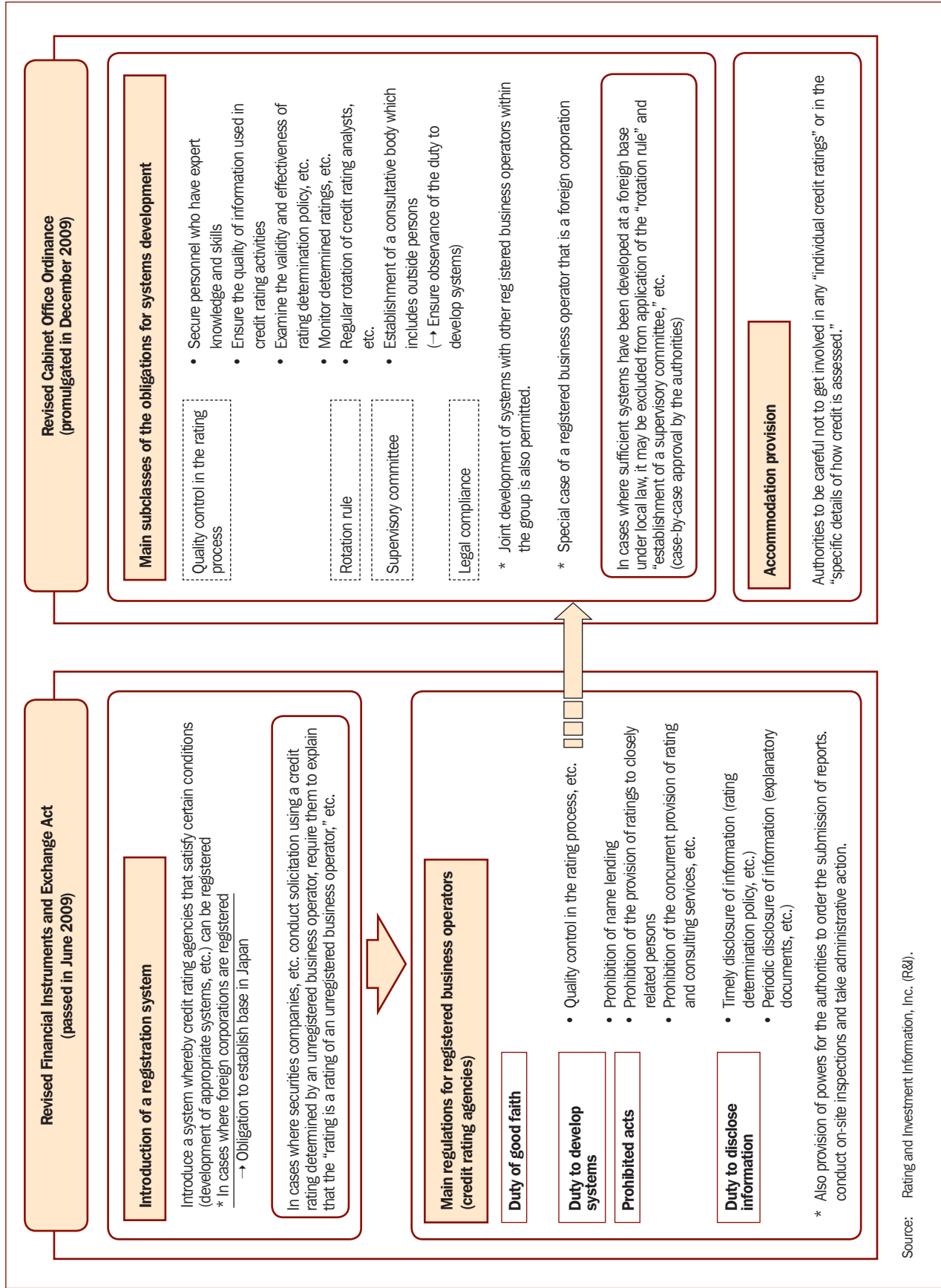
The revised FIEA came into force on 1 April 2010. The accountability of securities companies came into force on 1 October 2010.

**Figure 1.3a Guidelines for Supervision of Credit Rating Agencies (Summary)**



Source: Rating and Investment Information, Inc. (R&I).

Figure 1.3b Guidelines for Supervision of Credit Rating Agencies (Reference)



Source: Rating and Investment Information, Inc. (R&I).

## I. Market Category: Public Offering and Private Placement

In the Japanese bond market, the FIEA distinguishes between public offering (PO) and private placement (PP) of securities very clearly, irrespective of whether they are domestic or foreign.

### 1. Public Offering

A public offering is generally subject to requirements to disclose the solicitation documents stipulated in the FIEA, whereas a private placement is not. The 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. In short, the following categories are not deemed to be a public offering but are offered:

- a. to a small number of investors (the Small Number [SN]-PP) or
- b. to qualified institutional investors (the Qualified Institutional Investor [QII]-PP) or
- c. to specified investors (the Offer to Specified Investors [SI]) (Japan Rule 2-31 offering or Japan Professional Securities Market [PSM] Offering)

### 2. Private Placement

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

#### a. The Small Number-Private Placement

The SN-PP is a private placement to less than 50 persons. 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 6-month period (in case of newly issued securities) or 1-month period (in case of already-issued securities) is 49 or less (the SN-PP); In calculating the number of solicited persons for the purpose of the SN-PP, which is less than 50 during a 6-month period or 1-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-b) (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, an 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 Japan Securities Depository Center Inc. (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 Qualified Institutional Investor-Private Placement

The QII-PP is an offer for acquisition to be made exclusively to QIIs. 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 issuer’s agent who is a resident of Japan, according to Art. 1–3 of the *Cabinet Office Ordinance on Disclosure of the Contents of Foreign Bond Issuers* (外国債等の発行者の内容等の開示に関する内閣府令). The objective of this ordinance is to be considered to notice if there is a breach of obligation of the notice relating to the restrictions on resale. This ordinance is applicable just for the QII-PP and not applicable for the TOKYO PRO-BOND Market.

#### c. The Offer to Specified Investors

The Offer to Specified Investor (SI) is a newly added provision in 2008 under Japan Rule 2–31 Offering (Japan PSM Offering). 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. The definition of the “specified investor” is stipulated in Art. 2, Par. 31 of the FIEA. 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 SIs.
- 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 ‘specific security information’ with respect to the securities and the issuer. Specific security information basically refers to the information that combines two pieces of information about securities that are issued to specified investors and issuer information. If the issuer is a listed company, the specific security information means information about the security.

The TOKYO PRO-BOND Market was created based on this new scheme.

### 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 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. In calculating the ¥100 million, the 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 a Small Amount Placement where the minimum issuing amount (face value) is less than ¥100 million and more than ¥10 million, a Securities Notice (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.<sup>12</sup> Government bonds and Public bonds are exempt from the disclosure requirement. Such exemptions include the following:

- i. Transactions at stock exchanges;
- ii. Block trades between financial instruments business operators (i.e., securities companies and other financial institutions authorized to operate securities business) or SIs;
- iii. Certain transactions between financial instruments business operators;
- 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 (provided that transactions of both parties, of which are financial instruments business operators, 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;

<sup>12</sup> As stated earlier in the discussion on corporate bonds, asset-backed bonds and nonresident bonds are subject to disclosure requirements under the FIEA.

- 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.

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

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

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

For transaction (vii), an SRS, prospectus and SN are not required, although the financial instruments business operators offering foreign securities must, in general, provide a minimum level of information on the securities and the issuer at the time of offering, any time the investors make a request after the offering and at a time when certain material events (such as default of the issuer) occurs after the offering.

## J. Definition of the Specified (Professional) Investor

The definition of Specified Investor is prescribed in Art. 2, Par. 31 of the FIEA. The following are the categories of specified investors.

1. Qualified Institutional Investors (QII), meaning persons specified by a Cabinet Office Ordinance as those having expert knowledge of and experience with investment in securities;
2. The State (Japan);
3. The Bank of Japan (BOJ); and
4. 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).
5. Corporations and individuals that are deemed to be specified investors according to agreements (opt-in).

QIIs include securities companies, investment management companies, investment corporations, foreign investment corporations, banks, insurance companies, certain pension funds, and general partners of certain partnerships.

Juridical persons referred to in (4) above include companies whose shares are listed on stock exchange(s) in Japan, companies whose stated capital is likely to be ¥500 million or more, and foreign corporations.

The specified investors listed in (4) above may opt out of the status as SIs by an agreement with the financial instruments business operator.

Corporations and individuals that are not included in any one of (1) to (4) above may opt in by an agreement with the financial instruments business operator.

To become an SI, an individual is required to have net asset of ¥300 million or more, financial assets of ¥300 million or more, and investment experience at least 1 year.

## K. Creation of the New Market for Specified (Professional) Investor

The following is an extract of FSA's statement related to the new market for SIs.

### Box 1.1 Extract from Financial Services Agency on the Development of Markets for Specified (Professional) Investors

#### **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.*

##### *[3] Specified Financial Instruments Exchange Market (Japan rule 2-31 offering market) or (Japan PSM Offering Market)*

*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 (TSE) Group is limiting the investors to the TOKYO PRO-BOND Market as described below.

## L. TOKYO PRO-BOND Market: New Listing System in Japan

### 1. Preface

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. Here the market participants can see the opportunity to put an end to the state of isolation of Japan's domestic markets.



In 2008, the FSA 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 under Japan Rule 2–31 Offering Market) or (Japan PSM Offering Market), which is different from the general public offering system and has a wider range of investors than the U.S. Rule 144A market.<sup>13</sup>

In addition, the taxation system was reformed in FY2010 to reduce tax on revenues from domestic bonds held by non-residents to zero. 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, the necessity for separating domestic and international bonds will decline. The Japanese market participants will then witness a radical improvement in the mobility and the convenience of the Japanese corporate bond market.

## 2. New Listing System in Japan

### a. Objective

The TSE Group established the listing system as outlined below for bonds on the TOKYO PRO-BOND Market in May 2011.

- i. The TOKYO PRO-BOND Market is a specified financial instruments market as prescribed in Art. 2, Par. 32 of the FIEA.
- ii. The TOKYO PRO-BOND Market is operated by TOKYO AIM, Inc. (hereinafter, “the Exchange”) 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:
  - (a) **Straight bonds.** Corporate bonds listed in Art. 2, Par. 1, Item 5 of the FIEA (including bonds issued by mutual companies, but excluding bonds with warrants (as prescribed by Art. 2, Item 22 of the *Companies Act*).
  - (b) **Bonds issued by government agencies.** Bonds issued by legal entities pursuant to the special laws listed in Art. 2, Par. 1, Item 3 of the FIEA.

<sup>13</sup> The Rule 144A market is a market exempted from disclosure for private offerings under Rule 144A introduced to the *Securities Act of 1933* by the U.S. Securities and Exchange Commission in 1990. When bonds and other instruments targeting professional investors are issued in the U.S. markets, rather than employing public offerings, which entail stringent legal standards for document disclosure, it is normal to follow Rule 144A (*Securities Act of 1933*) and make the offering exclusively to qualified institutional buyers. In the U.S., the Rule 144A market is available as a domestic professional investor market and the *Regulation S* market is available as an offshore professional investor market that waive disclosure requirements. *Regulation S* provides for a safe harbor (i.e., exemption from disclosure) in the case of transactions conducted outside the U.S., while Rule 144A provides for a safe harbor even in the case of transactions within the U.S. for qualified institutional buyers. In both cases, resale within the U.S. is on principle restricted to qualified institutional buyers under Rule 144A.

The precursor of Rule 144A was Regulation D (1982), composed of Rules 501 to 508, and concerning private offerings made within the U.S. Regulation D stipulated the conditions for accredited investors. However, while Regulation D entailed an asset test, the precondition that an investor possessing assets had the ability to make judgments on all investments was criticized as being ludicrous, and Rule 144A replaces the asset test with an ownership and investment securities test (i.e., it incorporates elements of experience in investment in risk securities).

- (c) **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 Art. 2, Par. 1, Item 11 of the FIEA.
- (d) **Municipal bonds.** Municipal bonds listed in Art. 2, Par. 1, Item 2 of the FIEA.
- (e) **Specified company bonds.** Specified company bonds prescribed in the *Act on the Liquidation of Assets* listed in Art. 2, Par. 1, Item 4 of the FIEA.
- (f) **Beneficiary certificates of Special Purpose Trusts.** Securities enumerated in Art. 2, Par. 1, Item 13 of the FIEA, and the amount of cash distributions of which during the trust period are predetermined.
- (g) **Securities or notes issued by foreign countries or foreign entities.** Those that maintain the qualities of the above.
- (h) **Government bonds issued by foreign sovereigns.** Among the securities listed in Art. 2, Par. 1, Item 17 of the FIEA, instances that have the qualities of the securities listed in Item 1 of the said paragraph.

#### b. Initial Listing Application

- i. The listing of bonds on the TOKYO PRO-BOND Market is carried out through an application by issuers. It is not 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 is required to submit an initial listing application and initial listing application documents to the Exchange for listing.
  - (a) The initial listing applicant may consult or make inquiries with the Exchange prior to listing regarding the initial listing application.
  - (b) 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 is required to publish Specified Securities Information (specified securities information prescribed in Art. 27-31 of the FIEA) at the time of filing an application of a listing of bonds.
  - (a) Specified Securities Information is required to be prepared based on the format stipulated by the Exchange or other formats approved by the Exchange as appropriate. For example, the disclosure formats utilized in the Euro market may be approved to be used. Besides, the language of disclosure of Specified Securities Information is required to be either Japanese or English, or both. Foreign issuers do not have to translate their English documents into Japanese.
  - (b) Parties seeking to apply for a bond listing can register the maximum aggregate amount of bonds issued in a program by publishing the “Program Information” pursuant to the rules established the Exchange. Specifically, information on the maximum limit of the outstanding balance and other information shall be described in the Program Information, the validity period of which is 1 year (equivalent to Euro medium-term note [MTN] program). In the case where an issuer publishes the Program Information, such issuer is allowed to prepare the Specified Securities Information only with the remaining information. In the case where the issuer publishes the adequate Specified Securities Information after the registration of Program Information, the listing will be accepted by the Exchange following the

submission of an initial listing application and initial listing application documents including the Specified Securities Information.

- (c) Under the FIEA, if the initial listing applicant is a continuous disclosure company (a company which is obliged to submit the Annual Securities Report annually), publishing Issuer Filing Information (see 3 b (ii) below for details) is not required. Also, under the rules established by the Exchange, that the disclosure company can omit the corporate information from description in Specified Securities Information, provided that such Specified Securities Information contains a notice that the company submits the Annual Securities Report.

#### c. Qualification Requirements for Initial Listing Companies and Underwriters

The initial listing applicant must satisfy all of the requirements listed below when listing bonds on the TOKYO PRO-BOND Market:

- i. The said bonds obtain a credit rating from a CRA (meaning registered CRAs stipulated in Art. 2, Par. 36, of the FIEA and rating agencies established under foreign laws that are subject to frameworks of regulations and supervision equivalent to those of registered credit rating agencies.). A credit rating for the above mentioned Program Information may be used as the credit rating.
- ii. The securities company that serves as Managing Underwriter for bonds to be listed on the Exchange is required to be registered on the Exchange's Managing Underwriter List.
  - (a) Any securities company that wishes to register to appear on the Managing Underwriter List can apply with 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, among other things. The Exchange will also assess the ongoing eligibility of securities companies to be included on the Managing Underwriter List.
  - (b) The requirements for companies registered on the Managing Underwriter List will be different from 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 will have 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 approves the listing of the bonds and publicly announces it straightway in a timely manner.

### 3. Obligations after Listing

#### a. Timely Disclosure

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

- (a) The matters that the issuer of listed bonds is required to disclose are different from those for equity listings. The issuer of listed bonds is only required to disclose matters such as dissolution, bankruptcy or default. Disclosure of other information is optional.
- (b) Legally, in the case of corporate bonds, the important matters subject to insider

trading regulations are limited to dissolution, bankruptcy, or default (Art. 166, Par. 6, Item 6 of the FIEA, Art. 32-2 of the “Enforcement Order” of the FIEA, and Art. 58 of the “Order for Enforcement on Regulation of Trading of Marketable Securities”).

- (c) Timely disclosure obligations are not imposed on issuers of stocks listed on a domestic or foreign financial exchange, fully-owned subsidiaries of such issuers, or issuers of securities other than straight bonds, bonds issued by government agencies, and bonds issued by funds.

#### **b. Financial Information**

The issuer of listed bonds is required to publicly announce Issuer Filing Information as prescribed in Art. 27–32 of the FIEA at least once per year.

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

### **4. Delisting**

#### **a. Delisting**

In instances where the Exchange deems delisting appropriate, the Exchange will delist the said listed bonds, as enumerated below.

- i. To reach the final redemption date
- ii. Acceleration of the final redemption date in relation to the full amount of bonds
- iii. Absorption-type corporate split or new incorporation with succession by a new entity to obligations related to a listed bond issue
- iv. Material misstatement by an issuer of listed bonds in the Specified Securities Information, Issuer Filing Information, or the Annual Securities Report
- v. Call for immediate redemption of listed bonds due to a default event
- vi. Further to the above, determination by the Exchange that delisting is appropriate.

#### **b. Warning Measures**

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**

Listing Fees to be paid by the issuer of listed bonds to the Exchange is charged on the registration of program information and listing of the bonds.

### **6. Trading System, Settlement and Clearance System**

The Exchange launched 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.

## **M. 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 minimum issuing amount (face value) of each bond is ¥100 million or more as prescribed by the Companies Act. This implies that the minimum face value of the note of ¥100 million or more will only be sold to professional investors and will not be sold to individuals. Other cases prescribed by the applicable ordinance of the Ministry of Justice are 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,

- a. 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*;
- b. services to be provided by a commissioned company are restricted to the management of bonds that have been issued and are outstanding; and
- c. 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 engagement of a commissioned company (this applies when the minimum face value of a bond is not less than ¥100 million), issuers can appoint a fiscal agent (FA); and
- c. The previous practice that the lump purchases of defaulted bonds that trustee banks have been making were discontinued, and discontinuation has been established.

Under the *New Companies Act* adopted in June 2005 (enacted in May 2006), a commissioned company for bondholders and its liability and power have been expanded.<sup>14</sup> More specifically,

- a. 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, 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;
- b. 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

<sup>14</sup> Footnote 9, p. 93-95.

- proceedings for the bond as a whole without obtaining a resolution of the bondholders' meeting; and
- c. 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.

In an investment environment where there have been very few corporate bond defaults, a commissioned bank or commissioned person (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 commissioned bank or commissioned person (corporate bond administrator), and the preservation attachment for corporate bondholders when the corporate bond is in default, and no discussion has been held regarding cost sharing.

## N. Japan Securities Dealers Association's Self-Regulatory Rules and Guidelines for the Bond Market

In light of most bond transactions conducted via OTC in Japan, JSDA, the full-fledged self-regulatory (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 JSDA's self-regulatory rules were introduced as administrative guidance by the financial authority. As the role of financial authority and JSDA 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,<sup>15</sup> 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, as specified below.

- a. OTC 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 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);

<sup>15</sup> Art. 16 of JSDA's *Regulations Concerning Publication of Over-the-Counter Trading Reference Prices of Bonds and Trading Prices* prescribes that 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").

- 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.

When JSDA members violate these rules, they are subject to disciplinary action by the JSDA (if a JSDA member commits a breach of the rules together with a non-member (customer), only the JSDA member is subject to the disciplinary action).

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 mainly by JSDA members, subjected to public comment and other processes, and finally approved by JSDA.

### Box 1.2 Japan Securities Dealers Association Regulations for Bond Transactions

- \*Regulations Concerning Underwriting, etc. of Securities
- \*Detailed Rules Relating to the Regulations Concerning Underwriting, etc., of Securities
- \*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 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

Source: Japan Securities Dealers Association

## 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 do not comply with these 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, JSDA collects and considers the opinions of market participants when setting new guidelines or revising or abolishing old ones.

Recently, 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 JGBs when-issued transactions.

### 3. Others

Besides the above, JSDA issues from time to time notices to association members in advance regarding standard procedures, 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.

## O. Tokyo Stock Exchange's Self-Regulatory Function

The TSE fulfills a number of duties related to the operation of a securities market. It examines companies to assess their suitability as listed companies, it requires these companies to comply with disclosure requirements so that investors are able to make informed decisions, and it provides a market place for those companies' shares to be traded. Pursuant to the FIEA, TSE has self-regulatory functions to maintain a transparent, equitable and reliable market. The provision of such a market helps support a healthy economy.<sup>16</sup>

The TSE has two units in relation to its self-regulatory function: the Listing Regulation Unit and the Compliance Unit.

### 1. Listing Regulation Unit

The Listing Regulation Unit is engaged in various activities to ensure the soundness and fairness of the securities market with a focus on issues related to listing. This unit is comprised of the following two divisions:

- a. The Listing Examination Division, which conducts examinations of companies aspiring to list on the TSE to determine each company's listing eligibility.
- b. The Listed Company Compliance Division, which conducts examinations related to information disclosure of companies already listed on the TSE, and determines their eligibility to continue to be listed.

### 2. Compliance Unit

The Compliance Unit is engaged in various activities to ensure the soundness and fairness of the securities market with a focus on issues related to trading participants. This unit is comprised of the following two divisions:

- a. The Participants Examination and Inspection Division, which conducts activities such as inspections of banks, securities companies, and other trading participants who possess the qualifications necessary to conduct securities trading on the TSE.
- b. The Market Surveillance and Compliance Division, which conducts detailed investigative activities to ensure that transactions such as insider trading, market manipulation, and other potentially unfair transactions do not occur, in order to preserve the fairness and trustworthiness of the securities market.

### 3. Self-Regulation Punishment and Dealing with Offenders

TSE Regulation handles any trading participant that violates the law or the stock exchange rules in accordance with Art. 34 of the *Official Trading Participant Regulations*.

<sup>16</sup> Tokyo Stock Exchange. <http://www.tse.or.jp/english/sr/compliance/gaiyo.html>



The “Disciplinary Committee” is an advisory body that, in addition to conducting inquiries, also handles penalty funds, censure, trading suspension, and limiting or canceling trading capabilities.

## P. TOKYO AIM’s Role as TOKYO PRO-BOND Market Self-Regulatory Organization

TOKYO PRO-BOND Market-related rules and regulations are provided by the TOKYO AIM, Inc.<sup>17</sup> TOKYO AIM is an SRO for the TOKYO PRO-BOND Market. Among others things, disclosure requirements under the FIEA such as SRS do not apply to the securities listed on the TOKYO PRO-BOND Market. Instead, disclosure requirements stipulated in the rules and regulations of TOKYO AIM, Inc. such as the Specified Securities Information and the Issuer Filing Information applies to them.

In principle, information on listed bonds and information on their issuers shall be disclosed pursuant to the TOKYO AIM’s TOKYO PRO-BOND Market “Listing Regulations and Enforcement Rules.”<sup>18</sup> Also, the listing, initial offering and trading (if any) of the bonds on and in the TOKYO PRO-BOND Market are regulated under TOKYO AIM’s “TOKYO PRO-BOND Market Listing Regulations and Enforcement Rules.” In addition to these, trading on the market is regulated under JSDA’s “Self-Regulatory Rules and Guidelines for the Bond Market.” TOKYO AIM’s “TOKYO PRO-BOND Market Listing Regulations and Enforcement Rules” and JSDA’s “Self-Regulatory Rules and Guidelines for the Bond Market” have a mutually important and complimentary relationship.

## Q. Bankruptcy Procedures and Bonds

There are four 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

<sup>17</sup> Tokyo AIM Inc. [http://www.tokyo-aim.com/english/files/news/110701\\_qa\\_revised\\_eng.pdf](http://www.tokyo-aim.com/english/files/news/110701_qa_revised_eng.pdf)

<sup>18</sup> Refer to TOKYO PRO-BOND Market Listing Regulations and Enforcement Rules at [http://www.tokyo-aim.com/english/rules/rule\\_collection.html](http://www.tokyo-aim.com/english/rules/rule_collection.html)

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 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, a 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 statutory bondholders' meeting system set out in the *Companies Act* is applicable only to the bonds issued by Japanese corporate issuers under Japanese law.

The "Asia-Pacific Restructuring and Insolvency Guide 2006" provides an explanation on the restructuring and insolvency frameworks of Asia-Pacific countries, including a report on Japan.<sup>19</sup>

## R. Legal Definition of Debt Instruments

### 1. Uniform Legal Framework for All Types of Securities

- a. The *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. JASDEC performs the role of the Central Securities Depository (CSD) in the book-entry transfer system in securities other than government bonds. In this law, the term CSD means "Designated Depository Institution." Book-entry bond transfer system participants must observe the rules established by the depository institution.

### 2. Dematerialization or Immobilization versus 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, and it is also not allowed to be owned in tax-exempt status under the Japanese taxation system.

### 3. Legal Ownership Structure of Dematerialized or Immobilized Securities

- a. In the book-entry transfer institutions, securities companies and financial institutions, as "Account Management Institution" may open an account for securities transfer.
- b. In the transfer account, the balance of their own account and the overall customer account are recorded respectively.

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<sup>19</sup> Asian Development Bank. 2006. *The Asia-Pacific Restructuring and Insolvency Guide 2006*. Malaysia: Shearn Delamore & Co. and PricewaterhouseCoopers. <http://www.adb.org/Documents/Guidelines/restructuring-insolvency/restructuring-insolvency.pdf>

- 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 there be 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.

## II. Disclosure Requirements

### A. Securities Registration Statement

To make the information contained in the Securities Registration Statement (SRS) and its attachments accessible to general investors, the Financial Instruments and Exchange Act (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 5 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 after 15 days have elapsed 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 7 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 below, the “Information Concerning the Legal System of the Home Country of the Issuer” must

also be disclosed. 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 Securities Registration Statement

The following are the methods of filing the SRS:

### 1. Complete Disclosure Method

The 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 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 document.

### 4. Shelf Registration Method

Frequent issuers that qualify to use the Reference Method can also use the Shelf Registration Method to render their issue more cost-efficient and timely. Any issuer who satisfies the requirements for registration by the Reference Method may register proposed offering(s) by filing with the relevant Finance Bureau an SRS 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, 7 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 SRS 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 SRS. 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 commercial papers (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 4 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. This is 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 Financial Services Agency (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 year (in the case of foreign governments or corporations, etc., within 6 months) and file the same with the Finance Bureau as provided in Art. 24, Par. 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 1 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 6-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 semi-annual 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 a certain important event occurs with respect to an issuer subject to the continuous disclosure requirement, it should prepare and file with the Finance Bureau 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 Electronic Disclosure for Investors' Network (EDINET).

The FIEA contains provisions similar to those applicable to the SRS for amendments to the annual securities report, semi-annual securities report or quarterly securities report, internal control report, and extraordinary report, as well as 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 the Cabinet Ordinance describing the forms of initial disclosure by foreign issuers are as follows:

### 1. Disclosure of Information Concerning Corporations

*Cabinet Office Ordinance on Disclosure of Corporate Information* (Ministry of Finance [MOF] Ordinance No. 5, 30 January 1973)

### 2. Disclosure of Information Concerning Issuers of Foreign Government Bonds

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

### 3. Disclosure of Specified Securities as defined under Art. 3-4 of the “Enforcement Ordinance” of the FIEA

*Cabinet Office Ordinance on Information, etc. on Specified Securities* (MOF Ordinance No. 22, 3 March 1993)

## E. Electronic Disclosure for Investors’ Network

Disclosure documents, such as the SRS, is filed using the 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 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 Finance Bureau and are made available to the public through the Internet. By using this system, issuers do not have to go to the Finance Bureau 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 Hyper Text Markup Language (HTML) and eXtensible Business Reporting Language (XBRL).

## F. Exempted Securities

As described earlier (see I. 2. Private Placement; page 24–26), Private Placement Securities are exempt from registration requirements.

Also, 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., International Bank for Reconstruction and Development [IBRD] bonds and Asian Development Bank [ADB] bonds) are exempted from the registration requirement.

However, Fiscal Investment and Loan Program (FILP)-agency bonds issued by corporations established by a special laws (i.e. Development Bank of Japan Inc, Metropolitan Expressway Company Limited, Hanshin Expressway Company Limited, Narita International Airport Corporation, Kansai International Airport, Chubu International Airport) are subject to registration requirements.

# III. Trading of Bonds

## A. Overview

In general most of Japanese domestic investors tend to hold bonds till maturity. Having said that, the selling of bonds for switching, for profit taking and loss cutting are often undertaken by institutional investors. In recent years, by the time of the recent financial crisis of 2007-2008, bond trading volume in the secondary market continued to increase. The trading volume reached the level at ¥12,534 trillion in fiscal 2007. The sharp increase in the trading volume of bonds may be explained by a number of factors, including the following.

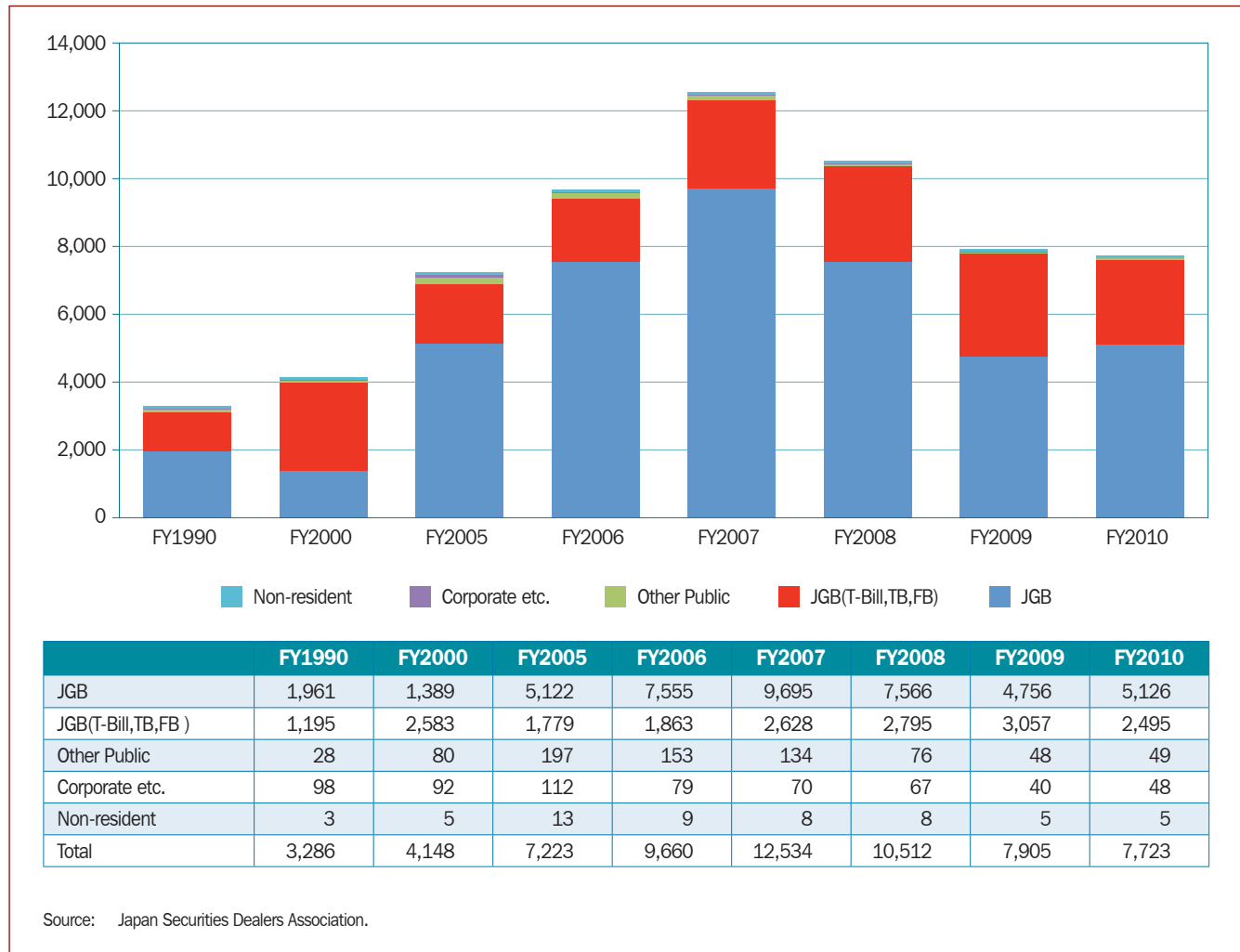
First, the government has continuously been issuing massive amounts of Japanese government bonds (JGBs), resulting in a large increase in those outstanding in the market.

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 financing 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. After 2007, 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 prefer outstanding liquidity and Bank for International Settlement (BIS) zero risk weight of Japanese government debts.



**Figure 3.1 Trading Volume of Bonds (¥ trillion)**

## B. Participants in the Secondary Bond Market

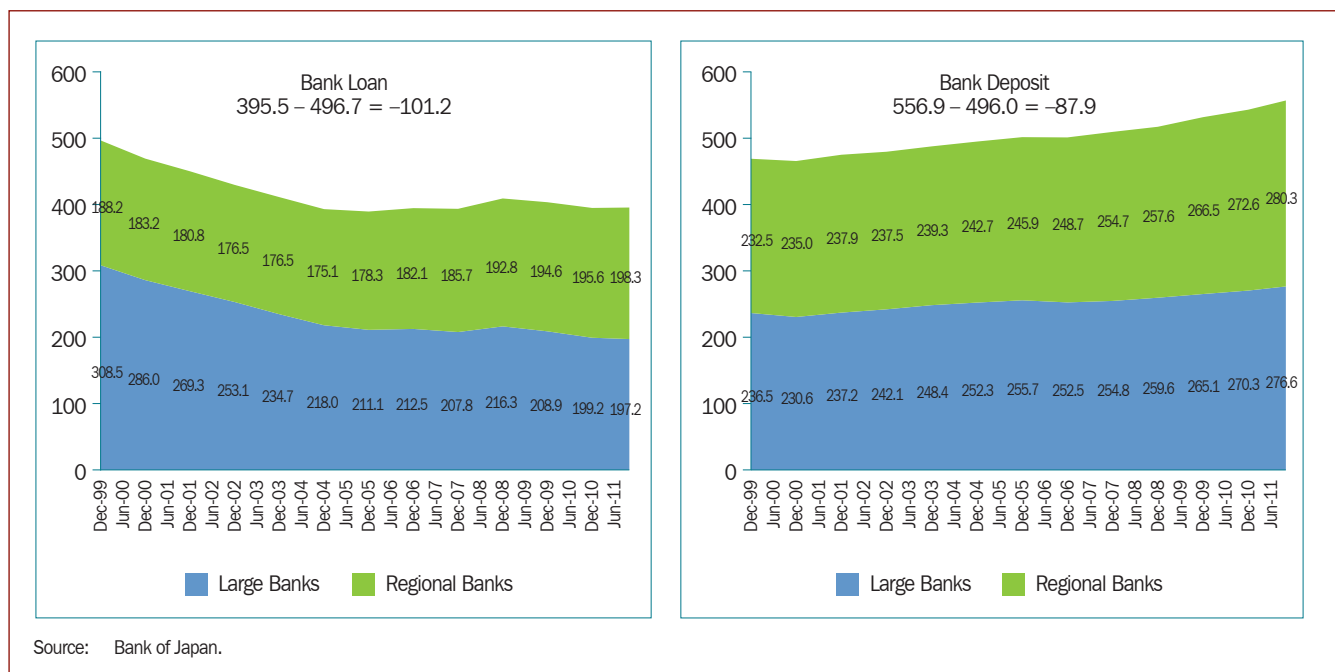
1. Looking at the over-the-counter (OTC) bond market by type of investors or transaction parties, trading is dominated by bond dealers, such as securities companies and banks.
2. Following bond dealers, entities grouped as “Others” account for the next largest share of the total volume. This “Others” category has become a consistent and substantial net seller of bonds because primary JGBs issued by auction are settled via the Bank of Japan (BOJ) and reported as sales by the central bank. Also, JGB is buying and selling a range of debt securities as part of its open market operations.
3. Non-resident investors also are playing an increasingly and significantly large role in the Japanese bond market as a means of investing in yen-denominated government bonds and notes over the past few years in line with the flight to quality movement after the financial crisis. They are also active players in the short-term JGB market, trading TBs, FBs, T-bills, and others.

4. 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, over the past 11 years, as seen in the following table, almost all business categories have been net buyers of bonds (almost JGBs and other public sector bonds). This can be attributed to the several reasons from the demand side point of view that

- (1) continuous repayment of bank loans from domestic business corporate borrowers who have generated cash constantly with their lean and efficient management,
- (2) financial institutions' reduced risk tolerance in their loan portfolios, and
- (3) continuous increase in bank deposits and savings from households and domestic corporations.

**Figure 3.2 Decrease in Bank Loan and Increase in Bank Deposit (December 1999–October 2011)**



The lower appetite for risk assets has surfaced among general investors, financial institutions and non-resident investors. This trend is also evidenced by continuing depression of the stock market, and disruption and subsequent downturn in the securitization markets after the financial crisis. This trend has been continuing and even getting stronger all over the world due to tightening of financial regulations after the financial crisis and the recent Euro zone crisis. This also promoted the trend to ‘flight to quality’ and ‘flight to liquidity’ for the JGB market further.

Table 3.1 Trends in Bond Transactions by Type of Transaction Parties (¥ billion)

		FY2000	FY2001	FY2002	FY2003	FY2004	FY2005	FY2006	FY2007	FY2008	FY2009	FY2010
City (commercial) banks	Sell (a)	62,618	67,740	98,201	80,125	92,172	79,387	75,391	120,557	129,292	126,905	146,494
	Purchase (b)	97,158	90,876	140,223	136,553	173,056	153,964	101,749	130,459	154,818	163,965	144,559
	Net (a)-(b)	(34,540)	(23,136)	(42,022)	(56,428)	(80,884)	(74,577)	(26,358)	(9,902)	(25,527)	(37,060)	1,934
Regional banks	Sell (a)	10,624	11,002	13,362	14,001	10,980	10,442	9,814	15,104	13,657	16,535	18,641
	Purchase (b)	16,770	18,605	20,839	22,420	19,385	16,967	14,375	21,141	23,678	28,251	29,938
	Net (a)-(b)	(6,146)	(7,603)	(7,476)	(8,419)	(8,406)	(6,525)	(4,561)	(6,037)	(10,021)	(11,716)	(11,297)
Trust banks	Sell (a)	49,639	50,481	72,041	68,158	69,171	77,368	84,376	100,520	80,563	82,886	92,597
	Purchase (b)	66,472	65,067	93,956	102,617	117,218	119,187	128,489	141,377	120,323	158,872	156,712
	Net (a)-(b)	(16,834)	(14,586)	(21,915)	(34,459)	(48,047)	(41,819)	(44,113)	(40,857)	(39,760)	(75,986)	(64,115)
Agriculture-related banking institutions	Sell (a)	6,557	5,933	9,046	8,188	8,505	7,164	12,599	8,908	6,646	7,159	4,953
	Purchase (b)	13,414	14,571	15,341	19,517	12,008	12,959	14,377	9,231	20,007	37,145	44,972
	Net (a)-(b)	(6,857)	(8,638)	(6,295)	(11,328)	(3,503)	(5,796)	(1,778)	(323)	(13,360)	(29,986)	(40,019)
2nd Regional banks	Sell (a)	2,146	3,249	4,607	3,833	4,057	4,104	2,628	2,571	2,910	4,716	4,899
	Purchase (b)	3,467	6,498	7,265	5,451	5,435	5,232	3,191	5,007	5,444	7,563	6,958
	Net (a)-(b)	(1,321)	(3,248)	(2,658)	(1,618)	(1,378)	(1,128)	(564)	(2,436)	(2,534)	(2,846)	(2,059)
Shinkin Banks	Sell (a)	6,623	7,587	9,830	9,086	9,157	7,002	4,571	7,170	9,997	9,963	15,361
	Purchase (b)	14,580	18,497	19,282	15,909	17,940	24,217	15,279	26,889	30,588	31,911	28,825
	Net (a)-(b)	(7,957)	(10,910)	(9,453)	(6,824)	(8,783)	(17,216)	(10,708)	(19,719)	(20,590)	(21,947)	(13,464)
Other Banks and Fin.Insts.	Sell (a)	22,587	14,429	16,169	41,274	18,830	16,404	19,375	26,341	22,250	12,586	11,642
	Purchase (b)	35,805	24,173	32,545	68,761	50,153	38,933	48,635	62,832	54,833	45,359	44,382
	Net (a)-(b)	(13,218)	(9,745)	(16,376)	(27,487)	(31,323)	(22,529)	(29,259)	(36,491)	(32,583)	(32,773)	(32,740)
Life and property casualty insurance companies	Sell (a)	22,188	22,320	18,690	14,807	13,802	12,556	13,684	14,076	16,805	9,539	13,642
	Purchase (b)	32,928	38,219	25,015	19,879	22,515	20,255	22,090	23,485	29,140	26,968	28,216
	Net (a)-(b)	(10,741)	(15,899)	(6,325)	(5,072)	(8,713)	(7,698)	(8,405)	(9,409)	(12,335)	(17,429)	(14,574)
Investment trust	Sell (a)	8,569	9,971	5,266	7,140	5,828	4,338	5,529	6,210	7,108	4,833	4,615
	Purchase (b)	39,639	47,235	26,384	27,766	26,171	28,313	28,238	25,992	22,088	23,730	24,216
	Net (a)-(b)	(31,070)	(37,264)	(21,118)	(20,626)	(20,343)	(23,976)	(22,709)	(19,782)	(14,981)	(18,896)	(19,601)
Public employees mutual aid associations	Sell (a)	2,620	1,060	864	794	1,529	1,631	1,288	877	880	612	515
	Purchase (b)	2,365	2,243	1,841	6,535	7,235	7,542	6,930	6,983	5,469	3,065	2,596
	Net (a)-(b)	255	(1,183)	(976)	(5,741)	(5,706)	(5,911)	(5,642)	(6,107)	(4,589)	(2,453)	(2,081)
Business corporations	Sell (a)	696	800	828	906	647	1,033	935	851	1,133	255	494
	Purchase (b)	4,100	3,514	6,514	7,225	8,849	8,125	11,230	10,453	9,996	12,759	13,894
	Net (a)-(b)	(3,404)	(2,714)	(5,686)	(6,319)	(8,203)	(7,092)	(10,295)	(9,602)	(8,862)	(12,504)	(13,400)
Other Corporations	Sell (a)	1,738	1,144	1,499	1,185	1,433	1,301	982	814	927	1,034	1,870
	Purchase (b)	5,579	4,967	4,599	4,598	4,652	5,334	7,659	6,240	5,929	5,626	6,162
	Net (a)-(b)	(3,841)	(3,824)	(3,099)	(3,413)	(3,220)	(4,033)	(6,677)	(5,426)	(5,002)	(4,591)	(4,293)
Non-resident investors	Sell (a)	50,664	46,886	49,105	58,329	71,436	86,480	99,016	122,127	103,251	91,808	99,307
	Purchase (b)	78,813	58,359	69,839	82,909	110,803	119,945	149,582	180,207	185,088	176,542	211,437
	Net (a)-(b)	(28,149)	(11,473)	(20,734)	(24,580)	(39,367)	(33,465)	(50,565)	(58,079)	(81,836)	(84,734)	(112,129)
Individuals	Sell (a)	661	650	719	621	610	471	328	303	322	492	629
	Purchase (b)	2,532	2,326	2,535	1,345	1,241	936	1,008	702	632	388	283
	Net (a)-(b)	(1,871)	(1,676)	(1,816)	(724)	(632)	(465)	(681)	(399)	(310)	104	345
Others (BOJ and Government sector + related agencies)	Sell (a)	191,371	225,165	258,436	291,187	357,108	313,203	334,295	334,439	358,574	437,704	403,892
	Purchase (b)	32,661	102,663	104,537	114,136	118,786	110,883	123,337	114,014	99,983	95,594	97,911
	Net (a)-(b)	158,711	122,502	153,898	177,051	238,322	202,320	210,957	220,425	258,591	342,109	305,981
Bond dealers	Sell (a)	590,923	585,148	612,515	724,262	788,988	755,991	874,516	978,710	868,471	842,434	908,691
	Purchase (b)	592,413	583,680	613,989	724,235	785,890	753,012	872,644	974,208	870,291	844,919	905,541
	Net (a)-(b)	(1,490)	1,469	(1,474)	27	3,098	2,979	1,872	4,503	(1,820)	(2,485)	3,150
Total	Sell (a)	1,030,225	1,053,564	1,171,180	1,323,896	1,454,252	1,378,873	1,539,328	1,739,578	1,622,784	1,649,462	1,728,243
	Purchase (b)	1,038,697	1,081,492	1,184,705	1,359,855	1,481,338	1,425,804	1,548,812	1,739,219	1,638,304	1,662,656	1,746,602
	Net (a)-(b)	(8,472)	(27,928)	(13,525)	(35,960)	(27,086)	(46,931)	(9,484)	359	(15,520)	(13,194)	(18,359)

Notes: Figures exclude those of gensaki transactions.  
Source: The Japan Securities Dealers Association.

## C. Over-the-Counter Trading of Bonds

Majority of bond transactions take place OTC rather than on exchanges; 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 effectively traded over the counter, where trades are executed based on the terms individually negotiated between buyers and sellers. The Tokyo Stock Exchange (TSE), the Osaka Securities Exchange (OSE), and the Nagoya Stock Exchange (NSE) 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.

## D. Publication of Reference Statistical Prices for Over-the-Counter 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 the "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 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 is 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 or 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 market participants are considering the following based on the system in the U.S., the United Kingdom and the Republic of Korea to improve the transparency of bond price information and build credibility for the information.
- d. At present, JSDA does not have access to actual price data information on a daily basis. However, JSDA has been making representations in the deliberation of the “Study Group to Vitalize the Corporate Bond Market” (Group 4) that, in line with practices in many other markets in the Association of Southeast Asian Nations plus the People’s Republic of China, Japan, and the Republic of Korea (ASEAN+3), actual traded price information should be more useful as a source of bond price dissemination. The debate on this point is still underway.

### 3. Publication of Transaction Price

- a. For the time being, JSDA publishes the transaction price once a day after the trading hour finishes for issues with high liquidity. For the next stage improvement, JSDA and market participants are discussing how to 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, JSDA and market participants may consider the following ideas and implement them:

- a. Review 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;
- b. Putting off the reporting deadline

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

#### c. Others

JSDA and market participants will continue to exert efforts to improve the transparency of bond price information and build credibility for the information.

## E. Secondary Market Yields and Terms of Bond Issues

Generally, the yields at the new issue of particular types of bonds have come in line with yields of their comparable bonds. And, those yields level are also affected by the amount of new issues and secondary market trading volume.

### 1. Efforts in the Government Bonds Market

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. This replaced 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 10-year JGB is concerned, during a long period of time, the syndicated underwriting system, which is a non-competitive (conventional) system, has been maintained until the underwriting syndicated system was abolished in 2006. In contrast, for government bonds of other terms, over a period of a substantial length of time before 2006, they have been issued as determined by the tender or auction conditions, which is the so-called “Partial price competitive tendering system.”

Over a considerable long period of time, market participants and government officials have been making 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 the growing portion of government-guaranteed bonds, which 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 pre-marketing process to identify and estimate investors' demand and determine the terms of issue accordingly.

## 2. Efforts in the Corporate Bonds Market

In the corporate bond market, determining the method of the issuing condition has been developed over the past 2 decades.

### a. Proposal Method

In the corporate bond market, the proposal method was launched in 1988 based on the recommendation of the Securities and Exchange Committee of the Ministry of Finance (MOF) at that time to abolish permanent fixed-member syndicate and introduce free competition among securities firms. Under the proposal method, the issuer, taking account of relationship to a certain extent, selects a lead manager mainly based on proposed issuing price for issuer's requesting terms and conditions. This method worked based on the terms and conditions presented by the issuer. Accordingly this method had the strong features 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 issuers or investors could confirm fair pricing due to undeveloped and illiquid secondary market conditions. Trustworthiness and confidence on pricing offered by the lead manager caused serious doubts in all the cases.

### b. Negotiated Method

In 1991, Nippon Telegram and Telephone (NTT) dropped the proposal method and introduced new method to appoint lead manager(s). Even under the immature, undeveloped bond market, (for some reason) even though the secondary bond market liquidity has been declining at that time, it was necessary to seek for fair pricing. In order to achieve fair pricing, "the JGB spread pricing new issue under the negotiated method" plus "the Fixed Price Reoffer with Syndicate break for launching (released

to the syndicate selling group with the uniform fixed reoffering price) method” were developed and introduced in the corporate bond primary market.

Under the new negotiated method, NTT has not requested pricing indication from any securities firm since then. Instead, they put heavy weight on the proposal of a new issue strategy and commitment on secondary market maintenance in the 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).

This new scheme aims for fair pricing to reflect accurate investors’ demands under the prevailing market. For that purpose, the JGB Spread talk with investors was introduced to find out appropriate price as the benchmark to clear target issue amounts. Then, the corporate bond issue shifted to flat-sales price system.

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

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

Since then, many issuers, for realizing the fairer market pricing, have been trying various methods.

## F. 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 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 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.

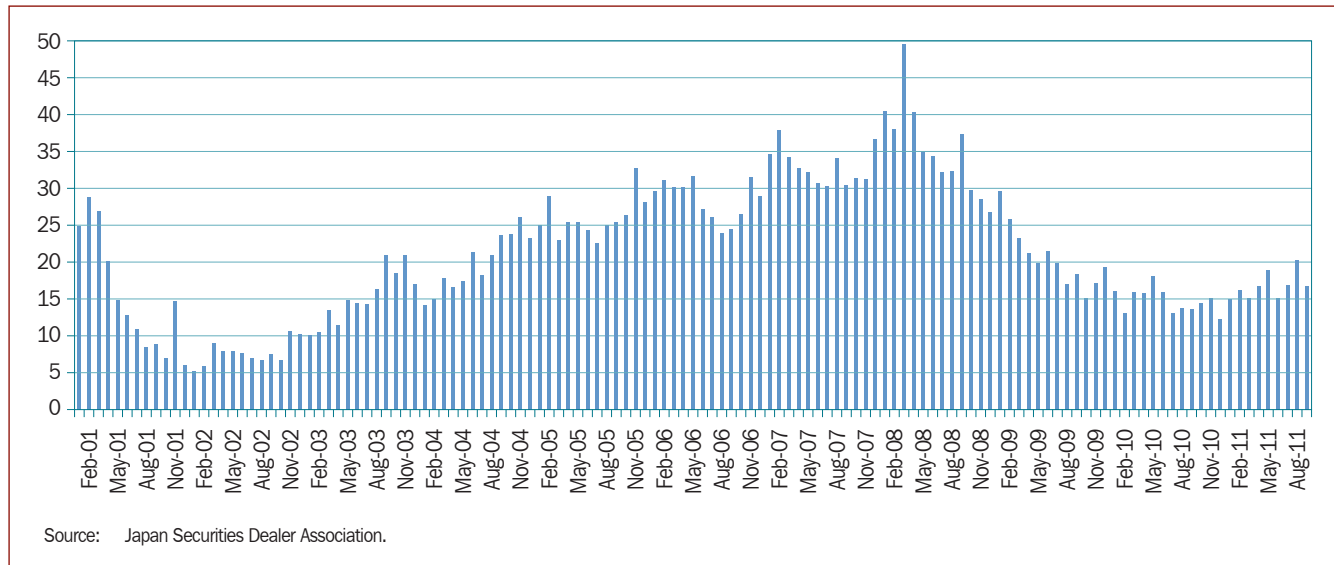
As the repurchase (or resale) price includes an amount equivalent to a return on investment or financing charge based on an agreement by the buyer and seller, the price does not usually tally with the prevailing market price of the bond at the time of its repurchase (or resale). Repurchase agreements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



with the BOJ's lifting of quantitative easing measures and other factors until the 2007–2008 financial crisis.

**Figure 3.3 Outstanding of Bond Transactions with Repurchase Agreements, January 2001 to September 2011 (¥ trillion)**



In the past, 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 short-term government securities market, interest-bearing JGBs have taken center stage since late 1990s, 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 was 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 necessitated reform. In particular, the gensaki market did not have functional risk management facilities or standard rules for dealing with counterparty default. Through 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 collaterals on account of a fall in the price of bonds submitted as collateral.

#### a. 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. This is done so that the value of the collateral will not be affected even when market price of the underlying bonds falls.

#### b. Introduction of Management of Collateral (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. Introduction of the Repricing System

In instances when the market price of the underlying bonds falls sharply from the prevailing market price 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 re-assessed based on market prices, and the difference between claims and obligations will be settled.

## G. 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 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 specified collateral (SC) torihiki (specified collateral trades), while those for financing and cash management without such specification are termed general collateral (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 at the end of fiscal 1996 (including approximately ¥17 trillion in cash-collateralized transactions) to ¥106 trillion at the end of fiscal 2008 (including approximately ¥97 trillion in cash-collateralized transactions). Since then, after the financial crisis, the recent balance is ¥72 trillion at the end of September 2011 (including approximately ¥70 trillion in cash-collateralized transactions).

Majority of bond lending transactions are conducted with government securities.

**Table 3.2 Bond Lending Balance as of 30 September 2011 (¥ trillion)**

	Borrowing Balance	Lending Balance
City banks	57,790	24,951
Regional banks	7,052	785
Trust banks	183,668	110,870
Financial Institutions for Agriculture and Forestry	9,266	22,030
2nd Regional banks	935	0
Shinkin banks	2,931	0
Other financial institutions	60,923	50,690
Life and Non-Life Insurance	32,129	3,560
Investment trust	0	1,461
Mutual Aid Association of Government Offices	0	0
Business corporations	2	42
Other organizations	60	8
Non-resident	16,132	10,223
Others	100,257	124,654
Bond dealers	249,814	371,685
<b>Total</b>	<b>720,959</b>	<b>720,959</b>
Collateralized portion	695,769	695,769
Note : 1 Figures are based on reports by all members of JSDA. 2 Trading in financial account is not included.		
Source: Japan Securities Dealer Association.		

## H. Proprietary Trading System for Fixed-Income Securities

### 1. Overview

The revision of the *Securities Exchange Law* in December 1998 led to the birth of Proprietary Trading System (PTS). The Financial Services Agency (FSA) announced the PTS guidelines in November 2000. According to the guidelines, although PTS operators are highly regulated by FSA and are 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, the needs for improving transparency, efficiency and accuracy in trading have been strong. It became stronger in the past several years due to the increase in compliance and/or governance requirement. PTS was supposed to be ideal to enhance the governance in trading. In reality, however, PTS has not been very successful in Japan, and it still has a long way to go.

### 2. Inter-Dealer Broker and Broker-to-Customer Market

There are two types of PTS operators: broker-to-broker (B-to-B, or inter-dealer broker [IDB] market) and broker-to-customer (B-to-C, institutional investor market).

#### a. Inter-Dealer Broker Market

The IDB market adopted the PTS promptly. The main operator of the IDB market is the broker's broker (BB), which in this case is Nihon Sogo Shoken. ICAP Totan Securities Co. Limited and Central Tanshi followed the IDB market.

BB has been active in e-trading and its PTS operation while other brokers have been lagging far behind BB. It is estimated that BB trades comprise 80% of the trade volume through PTS.

#### **b. Institutional Investor Market**

The B-to-C market has developed in a very different manner from the IDB market. There have been two main players in this market—JBOND and Yensai.com.

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 its PTS license in October 2002. Since then, the company operated the JGB PTS by gradually adding market makers and institutional investors.

Yensai.com was founded in January 2001 by seven major securities dealers following the business model of TradeWeb. It received its PTS license in March 2002. TradeWeb, a dominant player in the U.S. and Europe, was rather slow to enter the Japanese market. It received its PTS license in 2005 to trade foreign bonds. Trading of Japanese bonds 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 or broker. It is not regarded as a fully-fledged multi-dealer system provider.

FSA has encouraged asset management companies to adopt a trader-system, where dealers concentrate on dealing and fund managers focus on portfolio management. These FSA guidelines encouraged dealers to use electronic trading (e-trading) more often. At the same time, due to 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. Investors have started showing interest in PTS platforms gradually.

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

#### **c. Inter-Dealer Broker versus Broker-to-Customer Market**

As mentioned above, e-trading has grown in the IDB market in a short period of time but the B-to-C market has demonstrated very slow growth. The reason for this is not clear but this has been attributed to differences in trading attitude. Market makers want to know why investors are selling or buying in order to see where the market is heading. One of the important responsibilities of bond sellers is to find out investors' thinking and behavior. Thus, they call investors incessantly and provide the information back to dealers, which will be the basis for dealers in building up their positions. On the other hand, the IDB market is the place for squaring positions. The brokers' task is to match the trades. Therefore, telephone conversations are not very important in the IDB market. As brokers do not lose much by switching to e-trading, they did not resist the change much.

### 3. Pricing Method

FSA's guidance provides five pricing methods, which are:

- a. **Market Price-Trading Method.** This method uses current prices and quotes on the stock exchanges.
- b. **Direct-Negotiation Method.** This method uses a price negotiated between customers. It is often called “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 the B-to-C market have adopted this method.
- c. **Order-Matching Method.** Under the order-matching method orders from customers are matched with each other. 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 in their orders. Counterparties who wish to trade will click orders and trades are done. As the monitor screens are similar to the ones that IDBs use, IDB PTS operators use this method. The JBOND Repo System also adopted this method.
- d. **Quote-Driven Method.** In the quote-driven method market makers show their quotes and stand ready to trade with customers. It is often called the market-making method. Market makers show their bids and offers for bonds they wish to trade. They 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 is not popular among institutional investors.
- e. **Auction Method.**

For bonds PTS only (b), (c), and (d) are applicable.

### 4. Facilitators

#### a. Yensai.com

Yensai.com was founded by seven major securities dealers in January 2001 and its PTS operation started in 2002. It differentiated from other PTS facilitators with major Japanese market makers. It provides two types of trading method—real-time order system (a quote-driven system) and 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 to find out the current yield curve, and 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, on the other hand, has been relatively successful.

Currently, there are 13 securities dealers who participate as market makers for all interest-bearing JGBs.

**b. JBOND**

**JBOND**, another PTS operator, was founded in April 2002 and began its PTS operation in November 2002 and started the service before Yensai.com. It started its repo PTS in October 2009. Its participating market makers were mainly foreign banks.

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

**c. TradeWeb**

TradeWeb, a dominant player in the U.S. and Europe, was rather slow to enter the Japanese market. It was founded in 2004, received its PTS license in 2005 and started trading Japanese bonds in 2008. About 10 broker-dealers are participating but the activities are rather limited.

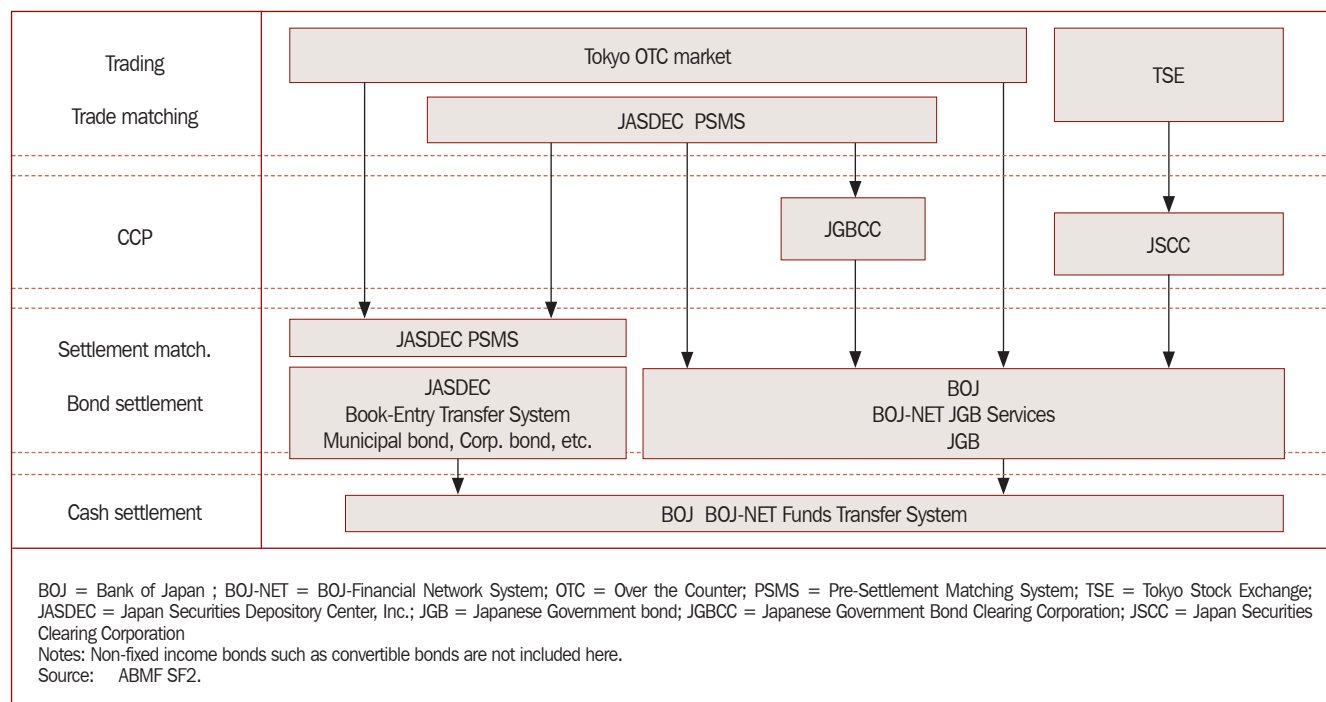
**d. Bloomberg**

Bloomberg also has a PTS license but its system is a gateway to lead an inquiry into a certain dealer-broker. However, it does not have significant influence in the market.

# IV. Bond Market Infrastructure

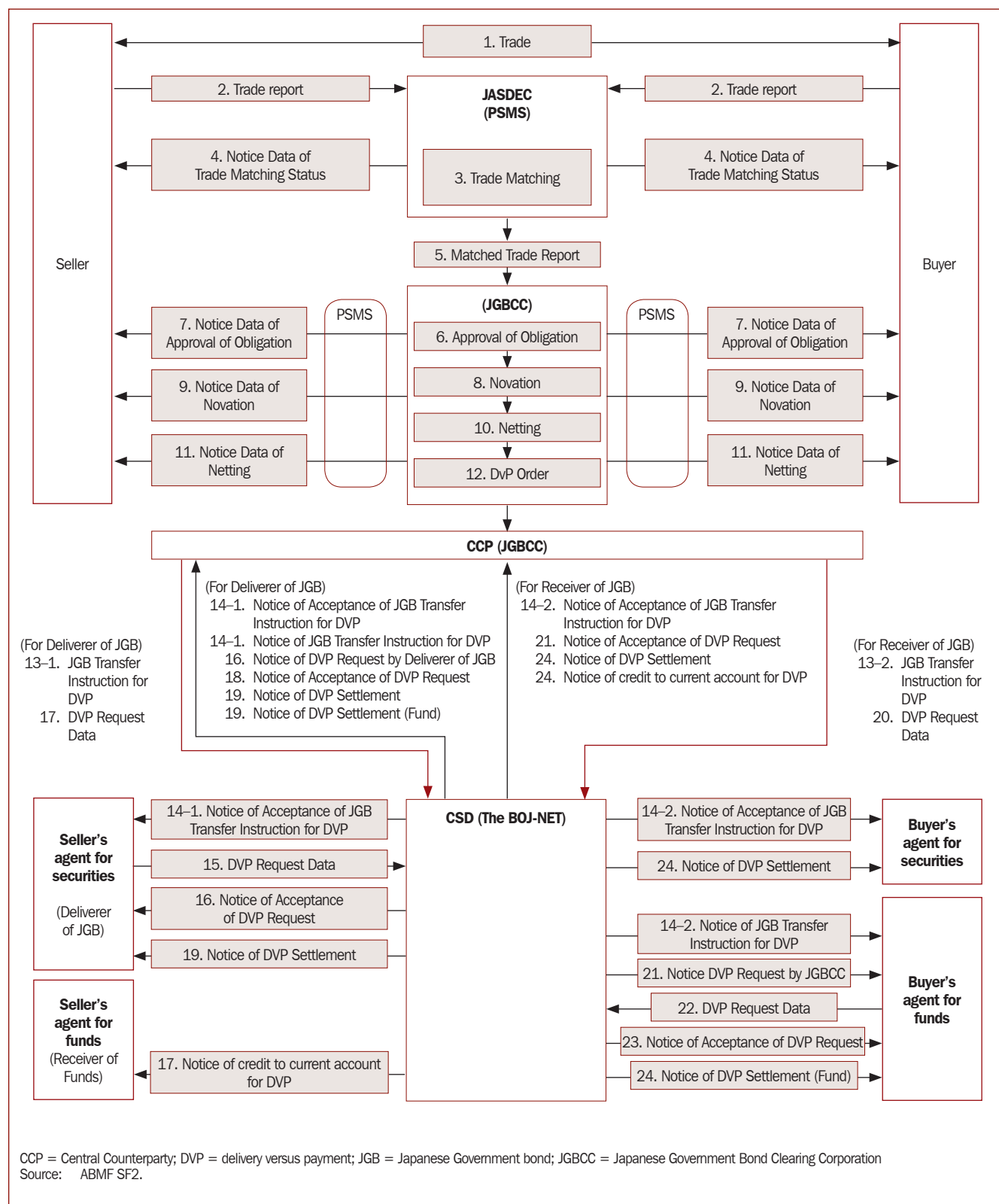
## A. Bond Market Infrastructure Diagram and Business Process Flowchart

Figure 4.1 Bond Market Infrastructure Diagram



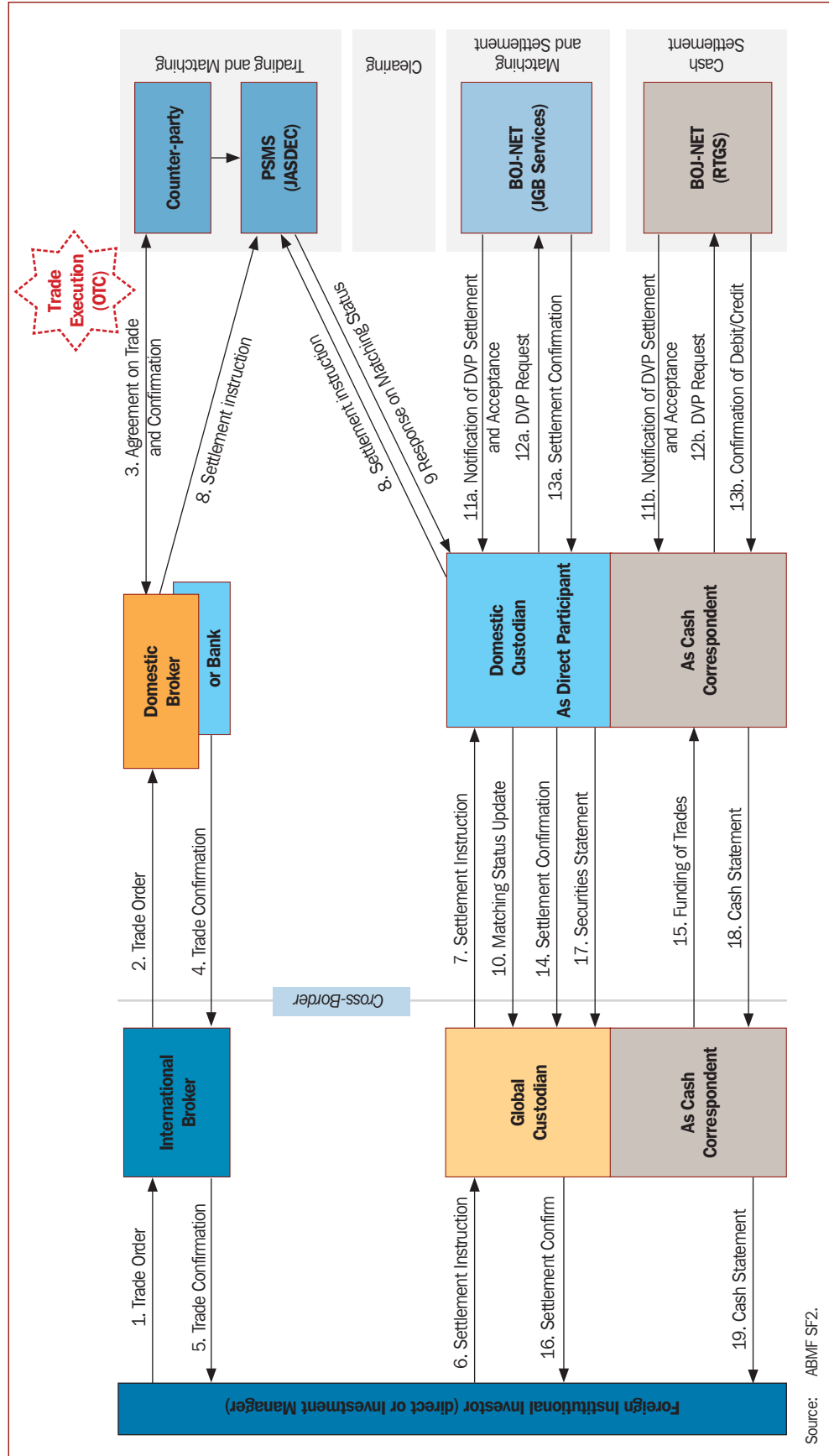


**Figure 4.2 Business Process Flowchart: Japanese Government Bond Market/Delivery versus Payment with Matching and Central Counterparty**



**B. Over-the-Counter Bond Transaction Flow for Foreign Investors (Including Cross-Border, Funding, and Reporting Components)**

**Figure 4.3 OTC Bond Transaction Flow for Foreign Investors**



### 1. Description of Steps in the Over-the-Counter Bond Transaction Flow for Foreign Investors

- (1) Foreign Institutional Investor places order with International Broker
- (2) International Broker places order with Domestic Broker/Bank
- (3) Domestic Broker/Bank trades over the counter (OTC) with Counterparty (via phone or e.g., Bloomberg)
- (4) Domestic Broker/Bank send trade confirmation to International Broker
- (5) Foreign Institutional Investor receives trade confirmation
- (6) Foreign Institutional Investor instructs Global Custodian on securities settlement details
- (7) Global Custodian instructs Domestic Custodian on securities settlement details
- (8) Domestic Broker and domestic Custodian input trade details into PSMS
- (9) Pre-Settlement Matching System (PSMS) responds with matching status
- (10) Domestic Custodian reports transaction status update to Global Custodian
- (11) Domestic Custodian/Direct Participant receive Notification of Delivery-Versus-Payment (DVP) Settlement and Acceptance from Bank of Japan (BOJ)-NET
- (12) Domestic Custodian/Direct Participant send DVP request to BOJ-NET
- (13) Domestic Custodian/Direct Participant as well as Japanese Government Bond Clearing Corporation (JGBCC) receive confirmation of DVP settlement
- (14) Domestic Custodian sends settlement confirmation to Global Custodian
- (15) Global Custodian funds account with Domestic Custodian, or into foreign currency (FCY) nostro (before end of day)
- (16) Global Custodian sends settlement confirmation to Foreign Institutional Investor
- (17) Domestic Custodian sends securities statement to Global Custodian
- (18) Domestic Custodian sends cash credit/debit confirmation in cash statement to Global Custodian
- (19) Global Custodian sends credit/debit confirmation in cash statement to Foreign Institutional Investor

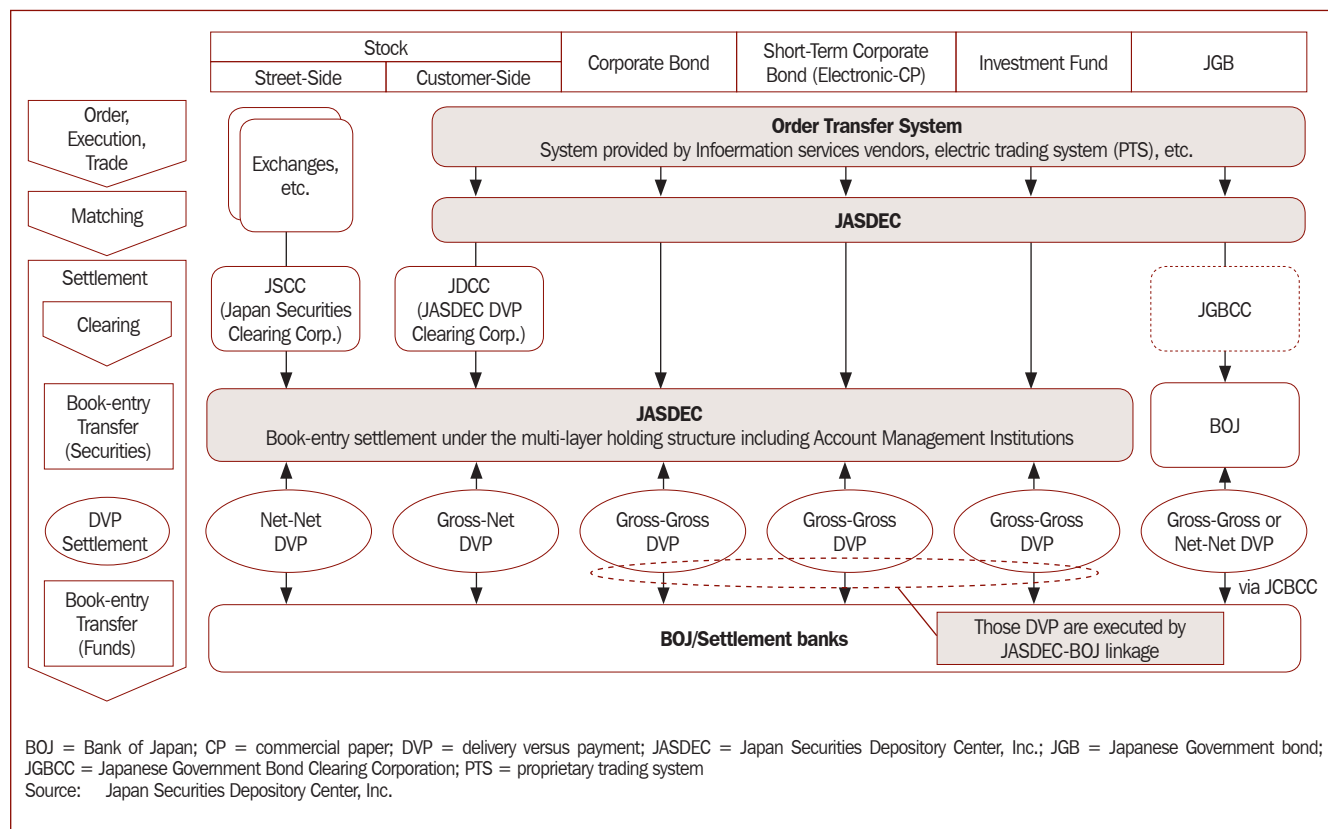
# V. Securities Settlement Infrastructure

## A. Securities Settlement Infrastructure

### 1. Existence of Central Securities Depository and Book-Entry System for Debt Instruments

- a. BOJ acts as the Central Securities Depository (CSD) and provides book-entry transfer system for Japanese government bonds (JGB).
- b. Japan Securities Depository Center, Inc. (JASDEC) acts as CSD and provides book-entry transfer system for corporate bonds.

Figure 5.1 Securities Market Infrastructure in Japan



## 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.

### b. Book-Entry Transfer System by Balance Management

Maintenance of smooth settlement has been possible with the introduction of book-entry transfer system. This enables right transfers by electronically recording the increase and 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 to enable flexibility of business development for AMIs and affiliation among international institutions.

### d. Delivery Versus Payment

Reduction of settlement risks has been improved due to DVP settlement, from issuance to redemption, including transfers.

### e. Straight-through Processing

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

## 3. Eligible Securities of Book-Entry Transfer System for Corporate Bonds

1. Corporate bonds
2. Municipal bonds
3. Investment company bonds
4. Corporate bonds issued by mutual companies prescribed under the *Insurance Business Act*
5. Specified corporate bonds prescribed in the *Assets Securitization Act*
6. Rights that should be represented by bond certificates issued by companies under special law
7. 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 Delivery-versus-Payment and Real-Time Gross Settlement Mechanism

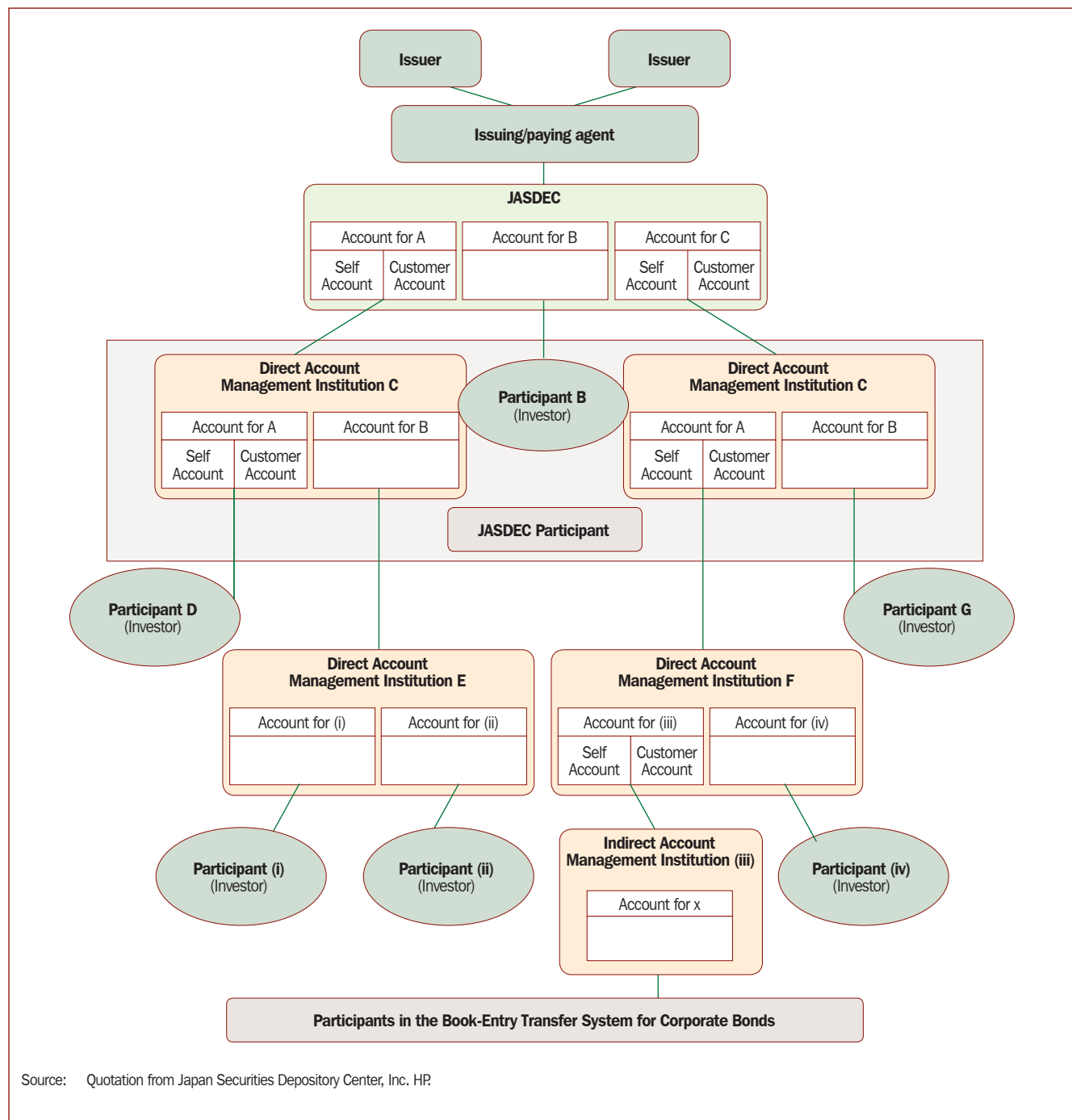
- a. JASDEC provides securities transfer system, and BOJ provides fund transfer system. The DVP mechanism consists of both systems, which are related mutually.
- b. Under the DVP mechanism JASDEC records the increase or decrease in the balance of beneficial rights in the transfer account book after PSMS confirmation.

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

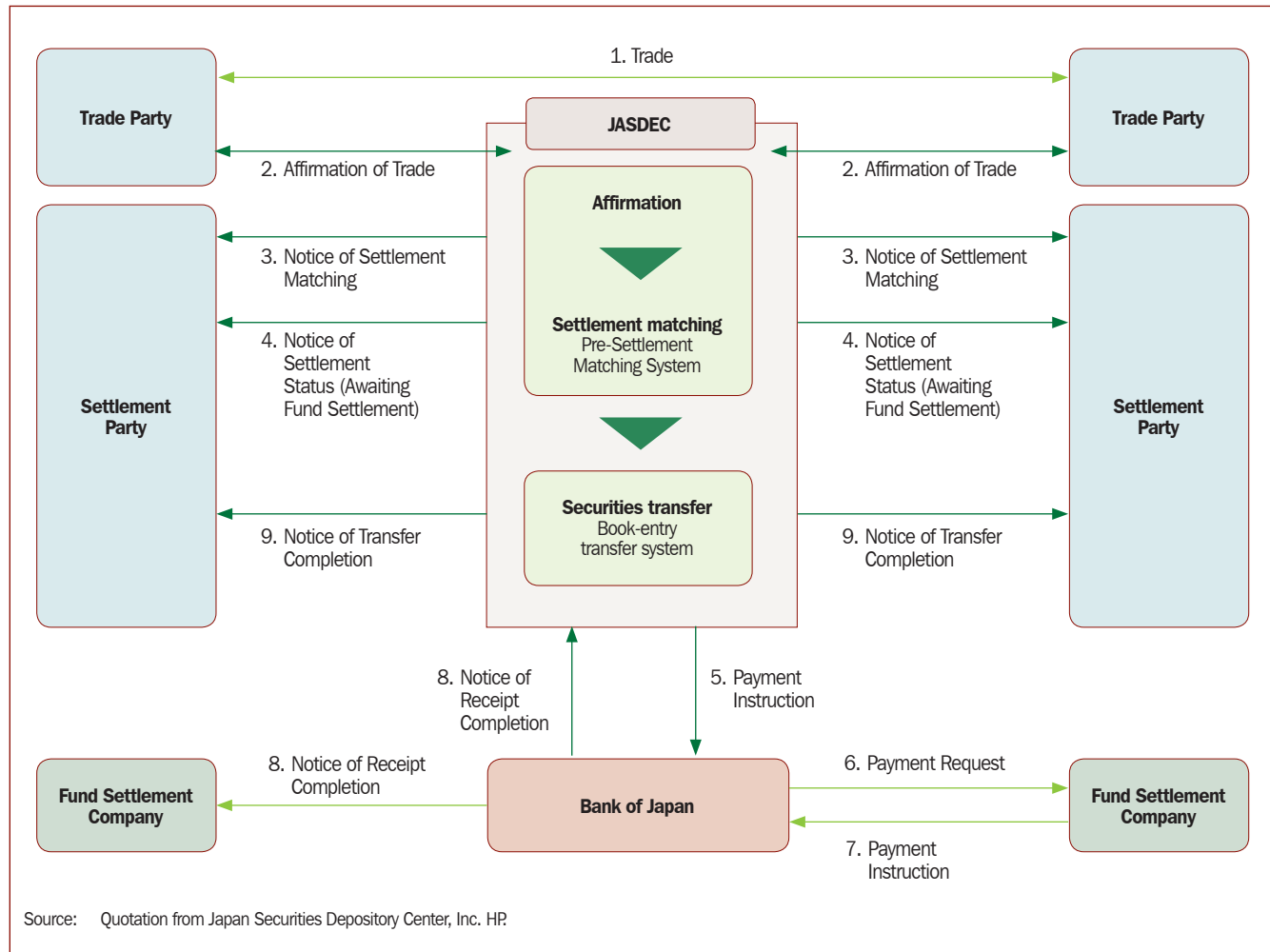
### 5. Existence of a Post-Trade Matching Mechanism

JASDEC provides PSMS for book-entry transfer system for corporate bonds (see Figures 5.2 and 5.3).

**Figure 5.2 Japan Securities Depository Center, Inc. Book-Entry Transfer System for Corporate Bonds**



Source: Quotation from Japan Securities Depository Center, Inc. HP.

**Figure 5.3 The Delivery-versus-Payment Mechanism**

### 6. Existence of an Execution Matching Mechanism

JASDEC provides PSMS and securities transfer system as a set. The Settlement Party uses PSMS to instruct about securities transfer of corporate bonds.

### 7. Settlement Scheme (Gross-Gross, Gross-Net, Net-Net) for Commercial Paper, Corporate Bonds, Government Bonds and other Debt Securities

The settlement scheme of JASDEC for corporate bonds and commercial papers (CP) is Gross-Gross.

### 8. Settlement Cycle for Commercial Paper, Corporate Bonds, Government Bonds and Other Debt Securities

The settlement cycle is currently Trade Date + 3 days (T+3). The Working Group of the Japan Securities Dealers Association (JSDA) is now discussing about shortening of settlement cycle of JGB.

## B. Challenges and Expected Changes

### 1. Issues on Current Settlement Infrastructures

Liquidity provisioning mechanism and liquidity-saving mechanism are currently lacking in JASDEC's book-entry system for corporate bonds.

### 2. Expected Changes on Settlement Infrastructures

- a. The CCP is expected to reduce of settlement risk and provide netting facilities.
- b. The realization of a liquidity-saving mechanism with the Next Generation RTGS of the BOJ-NET is expected.

## C. 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 the form of physical certificates that had been issued by the issuer; in registered form, where bondholders were registered on the registry at the designated registrar 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, certificates that 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 with the increasing bond trading volume and a growing call for a flexible framework and an expedited process for the settlement of transactions. Meanwhile, 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 rectify 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*. Its objectives including the complete dematerialization of securities, shortening the settlement cycles, and the reduction in settlement risk. The amended law provided the legal framework for the new book-entry transfer systems for corporate and government securities. This law was further revised to the *Law Concerning Book-Entry Transfer of Corporate Bonds, Stocks, and Other Securities*.

On the basis of this framework, the BOJ improved the existing JGB book-entry system in January 2003, and JASDEC started operating a new central custody and book-entry transfer system for securities, including non-government bonds, in January 2006. These book-entry transfer systems have a multi-tier tree-like structure, with a central



custody and transfer agent—the BOJ for JGBs, treasury bills (TBs), and financing bills (FBs), and JASDEC for 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.

The bond holdings of system participants are registered or recorded in the transfer account book kept by the account management institution with 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 the Japan Securities Depository Center

JASDEC (this term will also be used for the current Japan Securities Depository Center, Inc.) was established as a non-profit foundation on 6 December 1984 with the objective of streamlining the delivery of stock certificates. On 27 May 1985, JASDEC was designated as a depository under the *Central Securities Depository Law* (1984 Law, No.30) by the Minister of Justice and the Minister of Finance. It commenced depository services on 9 October 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 immediately develop 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 “[i]t 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 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. 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 realize the need to change the CSD to enable JASDEC’s corporatization. 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 in the case of the TSE, where its legal person (or corporate) status remained 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 are public-interest corporations, differs significantly from the legal system governing business corporations, i.e., profit-making corporations. 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, 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), which governs the issuance of electronic CPs, came into force. 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 10 January 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 to ensure governance by participants. An

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

### 3. Japan Securities Depository Center, Inc. and the Promotion of Reform of the Securities Settlement System

In recent years, many countries have vigorously implemented reforms in their securities settlement systems to enhance their competitiveness in capital markets. Japan is also engaged actively in the reform process, employing information technologies (IT) and launching DVP (a settlement system to avoid outstanding balances) and STP (electronic processing of trading through settlement).

#### a. Establishment of Short-Term Corporate Bond (Electronic Commercial Papers) Depository and Book-Entry Transfer System

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

Traditionally, CPs 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 adopt 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. As a result, electronic CPs create flexibility in capital management and financing.

#### b. Implementation of the General Delivery-Versus-Payment Settlement System

The DVP settlement system is essential to avoid 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 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 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 a CCP by taking collaterals from the DVP clearing parties and managing risks.<sup>20</sup> While the capital is settled in net amount at the end of the day, as 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 TSE and the Osaka Securities Exchange (OSE) in May 2001.

The JSCC has also implemented DVP as CCP since January 2003.

#### 4. Expansion of Pre-Settlement Matching System

The 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 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 1 April 2002). In addition, in May 2003, PSMS was expanded to cover JGBs, 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 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, Fiscal Investment and Loan Program [FILP] - Agency Bond and Local Bonds)

Historically, the settlement of corporate bonds, investment-and-loan bonds, and local bonds was processed through the renewal of registration in 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, as well as the system to electronically process DVP settlements existed via a linkage with BOJ Net, there were still many physical invoice transactions issued in

<sup>20</sup> A Central CounterParty (CCP) is a clearing organization to accept debts and credits for those concerned and settle the account

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.* came 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 DVP settlement, it led to a significant advancement in the application of STP/DVP in securities settlement in Japan. The transition period for existing bonds issued as cash bonds and registered bonds ended 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 the computerized processing of securities instruments. This is 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, a majority of stockholders keep 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 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 nonresidents 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 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

paperless system and raise the ratio of pre-depository of paper-based stock certificates with JASDEC to ensure a smooth transition. The computerization of stock certificate processing was implemented 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 participants (i.e., 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. Current Japanese Market Situation

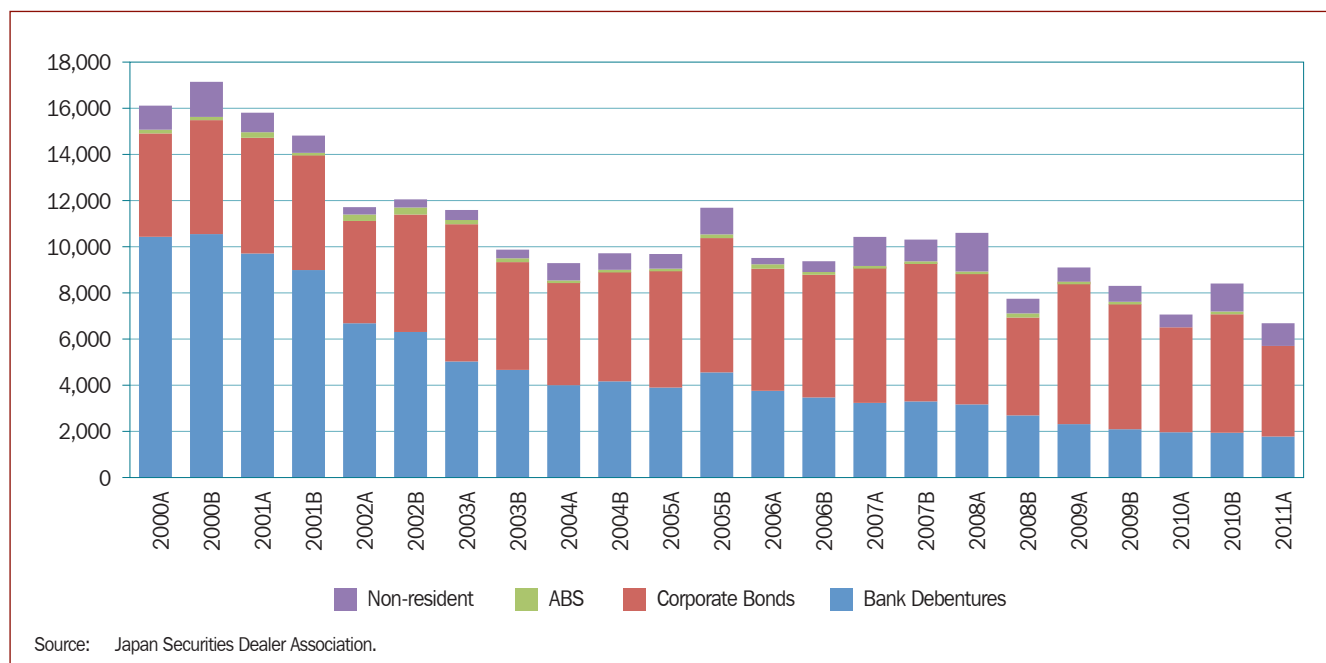
## A. Tide for the Change

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 nonresidents to zero. This is seen as 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, the necessity for separating domestic and international bonds will diminish, and Japanese market participants will witness a radical improvement in the mobility and convenience in 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, despite showing downward trend in the second half of 2008, the corporate bond market has shown relatively steady recovery towards 2009 and 2010. The 11 March 2011 earthquake and tsunami hit the market, and the performance of the first half of 2011 showed the slowdown. As a result of the people's effort for the recovery of the Japanese economy, the corporate bonds market has been in the course of recovery.

**Figure 6.1 Semi-Annual Issuing Amount of Non-Public Sector Bonds, January 2000–June 2011 (¥ billion)****Table 6.1 Semi-Annual Issuing Amount of Non-Public Sector Bonds (¥ billion)**

	Bank Debentures	Corporate Bonds	Asset-Backed Securities	Non-Resident
2000A	10,432	4,479	161	1,042
2000B	10,548	4,938	140	1,520
2001A	9,708	5,014	241	845
2001B	8,990	4,980	97	749
2002A	6,685	4,433	279	319
2002B	6,307	5,088	306	352
2003A	5,029	5,947	182	434
2003B	4,664	4,670	166	375
2004A	4,000	4,517	23	750
2004B	4,168	4,742	89	717
2005A	3,899	5,074	77	635
2005B	4,556	5,820	160	1,154
2006A	3,758	5,290	193	273
2006B	3,470	5,314	120	468
2007A	3,235	5,910	22	1,259
2007B	3,299	6,019	50	942
2008A	3,169	5,655	103	1,674
2008B	2,693	4,240	180	634
2009A	2,314	6,174	1	613
2009B	2,093	5,423	100	689
2010A	1,962	4,548	0	553
2010B	1,941	5,134	120	1,212
2011A	1,777	3,925	0	983

Source: Japan Securities Dealers Association.



2. However, generally speaking, comparing the Japanese corporate bond market with those in the U.S. and Europe (i.e., Euromarket), corporate bond issuance is not as robust as that of the U.S. market. Japan's ratio is low compared with in the United States. Additionally, the importance of corporate bonds as a fund management tool is significantly lower in Japan compared with the U.S. and Europe. Clearly, the Japanese corporate bond market remains a small market compared with the U.S. and European markets.
3. Although various types of companies actively issue corporate bonds in the U.S. and Europe (Euromarket), the issuance of corporate bonds in Japan is still limited to fairly high-rated companies in specific sectors.

As far as Corporate bond holdings in Japan are concerned, 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 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, 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. The 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 the Asian region. It will also help 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 players 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 the 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 the 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 have recently 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, 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 small- and medium-sized corporate finance demand, because of the government's active supportive measures

and financial policies to help private small- and medium-sized corporations and intensifying loan competition among financial institutions, including banks, large corporations and small- and medium-sized 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. As a result, conditions in the secondary market have not been properly reflected in the primary market in a timely manner. Additionally, although market participants 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 is not sufficiently reliable to serve the role of properly reflecting secondary market conditions. Furthermore, there may be room for further development and improvement of 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 conducting underwriting examinations (Type I Financial Instruments Business Operators), issuer, audit corporations, and certified public accountants 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; 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 trained sufficient analysts to conduct credit analysis of corporations, which has been 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 with 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-resident 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 is not a good place to actively invest for investors with a higher risk appetite.
- g. Defaults by issuing companies have been very rare in Japan. Therefore, sufficient data on the relationship between the credit risk of the issuers and issuance conditions have not been accumulated yet.

- h. In many cases, a negative pledge giving all corporate bonds the same priority is attached to a corporate bond.<sup>21</sup> As a result, when the issuer is in default, there is a concern that the rights of corporate bondholders 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, a commissioned bank or commissioned person (corporate bond administrators) has not been appointed in many cases except for corporate bonds targeting individual investors. Therefore, there is no consensus about the role of a commissioned bank or commissioned person (corporate bond administrator) and the preservation attachment for corporate bond holders when the corporate bond is in default. There is also 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 U.S. 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 (a) to (c) below. This is particularly significant in Japan. 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.

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<sup>21</sup> Negative Pledge Clause - A covenant provision in a bond agreement whereby the issuer agrees not to pledge any assets if such pledging would result in less security for the agreement's bondholders.

- 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 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. The related party has 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. The related party needs 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.
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, it is necessary to be developed infrastructure taking into consideration the similarity of corporate bonds to syndicate loans.
  5. Credit default swap (CDS) transactions have recently increased in the U.S. 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 and Expansion of Funding Sources

1. The professional securities market as shown above 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. This can be done through the establishment of public issue market for professional investors that eschews the legal disclosure requirements applied to retail investors.
2. The expansion and diversification of funding sources (greater distribution of debt portfolios) can be carried out by:
  - a. The creation of a professional issuing market employing English-language disclosure,<sup>22</sup> increasing convenience for overseas issuers.
  - b. Limiting market participants to institutional investors and other professionals to ease the obligation of disclosure for issuing companies, and thus expand opportunities for funding for Japanese and regional issuers.

## E. Inconvenience of the 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 strict disclosure requirements, which have originally been designed for the Japanese retail investors.
  - b. In reality most of the 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 do not have a 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.

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<sup>22</sup> Japan is in the course of introducing a partial English based documentation for disclosure from April 2012; Although the information for securities should be submitted in Japanese, a most part of the disclosure information for issuer (including already disclosed reference information) can be submitted in English, except for a certain information. (Non-resident issuers' burden will be reduced).

## F. Due Diligence by Securities Companies

### 1. Public Offering

All public offering in the Japanese domestic bond market is subject to due diligence, which are conducted in line with JSDA regulations “Rules for Underwriting Due Diligence of Securities” and “Detailed Manual on Rules for Underwriting Due Diligence of Securities” (hereafter “JSDA Due Diligence Rules”), by each underwriting syndicate member’s Due Diligence Department or Due Diligence Board who is obliged to manage due diligence independently from underwriting business promotion units such as corporate finance group, debt capital markets, investment banking group and the like. Unless JSDA Due Diligence Rules is fulfilled and approved by the Due Diligence Department or the Due Diligence Board, the securities company is not allowed to underwrite the bonds.

Also JSDA Due Diligence Rules require lead manager(s) to obtain a comfort letter. Exempt issuers such as sovereign and quasi-sovereign issuers may be outside the scope of the comfort letter.

JSDA Due Diligence Rules specifies what items to be checked from view point of FIEA and other relevant rules and regulations. Therefore, JSDA Due Diligence Rules are regarded as a formality examination rather than business due diligence.

### 2. Private Placement

JSDA Due Diligence Rules will not officially apply to small number-private placement (SN-PP), qualified institutional investor (QII)-PP, Offer to Specified Investors (SI). Having said that, due diligence will be conducted depending on an underwriter’s judgment on its necessity. Most cases will be business due diligence instead of formality examination based on JSDA Due Diligence Rule items. In the private placement scheme, an underwriter may acquire a comfort letter as long as relevant parties agree, although JSDA Due Diligence Rules do not require lead managers to acquire a comfort letter.

## G. Determination Process for Corporate Bond Issuance Conditions

The establishment of a 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. Market players have seen some corporate bond issuances that used the pot system in Japan. Market players believe that it is necessary for market participants to establish a guideline 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 establishing a rational determination process for corporate bond issuance conditions. Introducing the pot system in Japan may be one option. In any case, careful examination is required.

## H. Measures to Cope with Default Risk

For the 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 market participants plan to develop the following measures that will protect investors when business conditions deteriorate in 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 the 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 believes that such a flexible scheme should be maintained and enhanced in the future for vitalization of the corporate bond market.
- ii. Currently, covenants granted on a corporate bond issue mainly cover the negative pledge clause (a clause prohibiting the issuer from creating any security interest over a certain property specified in the provision) and cross acceleration.
- iii. While the negative pledge clause is a special agreement to protect 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 corporate bond default by a company with relatively higher risk.

- iv. In the future, when JSDA and 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 can exist when the bond issuer disapproves the covenants to avoid the issue.

- v. For this purpose, taking into consideration the examples in the U.S., JSDA and 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 as reference to issuers, investors, and securities companies. It will also be necessary to disseminate market practices that enable fundraisers 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 these issues, JSDA and market participants should address the use of secured corporate bonds issued by corporations with relatively higher credit risk and the relationship of these corporate bonds to the order of priority of loan pledges.

#### **b. Disclosure of Information on Covenants**

- i. The type of covenants 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 holders to check the covenants granted on other corporate bonds and loans. Holders 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 whether that is a standard practice in Japan.
- iii. As of the end of the fiscal year in 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 maintenance of net assets and maintenance of profits. There were a few companies that disclosed covenants relating to default such as cross acceleration.
- iv. In the U.S., 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 do not 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. The Form 8-K is a very broad form used to notify investors of any material event that is important to shareholders or the United States Securities and Exchange Commission. This is one of the most common types of forms filed with the SEC. After a significant event like bankruptcy or departure of a CEO [Chief Executive Officer], a public company generally must file a Current Report on Form 8-K within four business days to provide an update to previously filed quarterly reports on Form 10-Q and/or Annual Reports on Form 10-K. Form 8-K is required to be filed by public companies with the SEC pursuant to

the Securities Exchange Act of 1934, as amended. A Form 10-K is an annual report required by the U.S. Securities and Exchange Commission (SEC), that gives a comprehensive summary of a public company's performance. Although similarly named, the annual report on Form 10-K is distinct from the often glossy "annual report to shareholders," which a company must send to its shareholders when it holds an annual meeting to elect directors (though some companies combine the annual report and the 10-K into one document). The 10-K includes information such as company history, organizational structure, executive compensation, equity, subsidiaries, and audited financial statements, among other information.

- v. For the purpose of developing an environment where investors can be confident in making an investment in corporate bonds, JSDA and market participants need to discuss the following issues based on the disclosure system in the U.S., 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 bondholders 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 is 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. 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. Market participants can choose two approaches regarding the appointment of a commissioned company for bondholders: (a) appoint a commissioned

company for bondholders for all corporate bonds; or (b) appoint a commissioned company for bondholders of corporate bonds issued by a corporation with a relatively higher credit risk. For the time being, while discussing the tasks of the commissioned company for bondholders, it is useful for market participants to establish approach (b) as a market practice.

- vi. In the case of corporate bonds issued by a corporation with relatively higher credit risk, 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 a 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 the future, corporate bond issuers become more diversified and more corporations with relatively higher credit risk issue corporate bonds. Therefore, market participants need to take measures to increase the credibility and transparency of tasks assumed by the commissioned company for bondholders, as well as discuss what tasks they are to assume.

#### **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. Market participants 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 U.S. (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 U.S., there is a need to consider that, for example, the tasks of a commissioned company for bondholders will be limited to the preservation and recovery of debts after the default of corporate bond, or that a set different requirements will be set for appointing a commissioned company for bondholders and for its tasks depending on the credit risk of the issuer or the type of investors.
- v. It is possible that the position and the rights of corporate bondholders will be affected by an event concerning the corporate bond issuer besides default, such as mergers and acquisitions (M&A). Therefore, market participants 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. Taxation (Withholding Tax on Interest Income)

### 1. 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 Three-Year Temporary Measure)* was enacted. This measure intends to promote the investment in and holding of corporate bonds by foreign investors. JSDA and 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 as a permanent system.

### 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, there is a 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 market participants need to continue promoting the unification of tax treatment of financial income in cooperation with the relevant organizations and agencies.

### 3. Related Tax Information

The Japan 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 10% for local investors. This rate reduction lasted until 31 December 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.

## J. Bond Investment Education and Bond Investor Relations

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 nurtured enough analysts to conduct 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 with those adopted by other institutional investors.

3. Investor relation (IR) for corporate bonds is important as an interactive communication tool between the issuer and investors, and therefore, some parties 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 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 to promote further understanding on corporate bond investment.

## **K. Internationalization of the Bond Market and Collaboration with Asia**

1. To implement the concrete measures mentioned above, there is a 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, there is a need to fully open the Japanese corporate bond market to the global participants and make it easy to use not only for both domestic and overseas issuers and investors.
2. The Asian Bond Markets Initiative (ABMI), an initiative agreed upon at the meeting of financial ministers in ASEAN Plus Three countries (Japan, China, and Republic of Korea), is a scheme to comprehensively consider and take measures to foster harmonization in the bond markets in Asia, promote the issuance of local currency-denominated bonds, expand demand, and improve the regulatory framework and relevant infrastructure.
3. JSDA and 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.

## **L. Foreign Bonds, Foreign Exchange Control and 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 investment of savings. Generally, bonds require disclosure of information on the creditworthiness of issuers. Unlike currencies, however, there is no institution to control the supply of bonds, particularly international bonds or foreign bonds, such as a central bank in the case of currencies. However, markets control the supply of bonds through interest rates. Money laundering regulations and the *Patriot Act* are not applicable to bonds.

Generally, bonds are created under contracts and, as such, terms and governing laws can be varied for bonds under the principle of freedom of contract and the practices of jurisdictions. 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 in existing currencies (aside from the European Currency Union [ECU] basket account in the past, 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 Asian countries, the liberalization of its currency is an important issue. The Japanese experience may be of some use as an illustrative case.

## M. History of Japan's Foreign-Exchange Policy Change and the Liberalization of the Yen

The history of the relationships described above may be explained by Table 6.2 below.

**Table 6.2 History of the Foreign-Exchange Policy Change and Liberalization of the Yen**

Year	Event
1970	The Tokyo capital market was inaugurated; internationalization of the yen; Asian Development Bank bond.
1971	Nixon Shock: Dollar-gold convertibility suspended; shift of the yen to the floating-rate system in 1973.
1972	GTE stock public offering in Japan (first foreign stock).
1973	Australian government bond (first samurai bond issue).
1974	First German mark public offering of a corporate bond (Mitsubishi Heavy Industries).
1975	First Swiss franc public offering of a corporate bond (Mitsubishi Chemical).
1977	<ol style="list-style-type: none"> <li>Expansion of foreign exchange reserves, yen interest rates drop due to a decline in private-sector fund demand: a record issuance of samurai bonds.</li> <li>Lifting of the ban on the issue of Euroyen bonds by nonresidents: first issue by the European Investment Bank (EIB).</li> </ol>
1984	<p>Japan-U.S. Yen-Dollar Committee (Japan-U.S. financial market frictions prompting further internationalization of the yen).</p> <ol style="list-style-type: none"> <li>Substantial easing of issuer qualifications for nonresident Euroyen bonds.</li> <li>Lifting of the ban on the issue of Euroyen bonds by residents; Euroyen bonds, first 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).</li> </ol>
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; first 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. information technology bubbles.
2006	Electronic registration of corporate bond certificates started.
2010	Announcement of the commencement of the TOKYO PRO-BOND Market.

Source: ADB Consultant.

## N. Derivatives Market

### 1. Bond Futures Trading

Trading in securities futures (Government National Mortgage Association [GNMA] certificates) first started in 1974 in the U.S. Trading in 10-year government bond futures was conducted on the Tokyo Stock Exchange (TSE) in 1985—the year in which they were issued in massive amounts—which was the first financial futures trading in Japan.

In 1988, super long-term (20-year) government bond futures (discontinued in 2002) were listed on the TSE, and trading in U.S. Treasury bond futures—which had the largest trading volume in the world—started on the TSE 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 starting on the TSE 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 bond futures trading in Japan is that issues are traded in units with a total par value of ¥100 million, 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, the contract for difference futures (CFD) on mini-long-term government bonds, which are one-tenth the amount of normal bonds, were listed on the TSE from the end of March 2009, but no trading has occurred since June 2009.

## 2. Financial Futures Trading

Currency futures trading started in the U.S. 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 (whose 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 (TIFFE) in 1989. These contracts were followed by the TIFFE/Tokyo Futures Exchange (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 (GC) spot-next (S/N) repo rate interest futures.

Financial futures trading in the U.S. 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 was 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 1-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-Standard Portfolio Analysis of Risk (SPAN) 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 likewise 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.

## 3. 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. 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 over-the-counter (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 1 year, and as they cannot be resold to a third party, contracts usually run a relatively long period—6 months or 1 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 9 months, long-term government bond futures options offer up to four contract months with a maximum period of 6 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.

## VII. Fees and Costs

### A. Standard Underwriting Fees Schedule for Public Offering Bonds

**Table 7.1 Standard Underwriting Fees Schedule for Public Offering Bonds**

(bps)	SSA	Corporate	
	(sub-sovereign and agencies)	Prime	Standard
2 years	12.5	12.5	30.0
3 years	17.5	17.5	35.0
5 years	22.5	22.5	40.0
7 years	27.5	27.5	40.0
10 years	30.0	30.0	45.0
12 years	30.0	30.0	45.0
15 years	35.0	35.0	50.0
30 years	47.5	47.5	60.0

Source: ABMF-J Member.

### B. Book-Entry and Transfer Fees (JASDEC Account Holding Issuer, etc.)

From the rules concerning service fees applicable to the corporate bonds, etc. book-entry transfer system

**Table 7.2 Short-Term Corporate Bonds-Participation in the System**

Item of Service Fees	Parties to Pay	Service Contents	Rates
Account opening fees and system connection preparation fees	JASDEC Participants	Processing for opening accounts and setting up a system connection	(1) In the case where a party to pay newly becomes a JASDEC Participant: JPY 200,000 Provided, however, that, when two (2) or more Classified Accounts are opened with the same account name, the account opening fees and system connection preparation fees shall be JPY 200,000, increased by the amount calculated based on the rate set forth in (2) below for each of such Classified Accounts in excess of one (1).

*continued on next page*

Table 7.2 continuation

Item of Service Fees	Parties to Pay	Service Contents	Rates
			(2) In the case where Classified Accounts are opened (excluding the cases falling under (1) above):  JPY 50,000 per account Provided, however, that, when Classified Accounts are opened with the same account name for the first time, the account opening fees and system connection preparation fees shall be the amount calculated based on JPY 50,000 per Classified Account to be opened, minus JPY 50,000.
System connection preparation fees	Issuers	Processing for Issuer registration	JPY 50,000
	Persons appointed as Issuing Agents/Paying Agents; except for persons who have already been appointed as Issuing Agents/Paying Agents	Processing for setting up a system connection	JPY 50,000
Terminal connection fees	All users of the Integrated Web Terminal (excluding Fund Settlement Corporations)	Use of system resources through a continuous terminal connection	The rate of fees for use of system when the number of user IDs of an operational user is one (1) or more but not more than five (5):  JPY 10,000 per month, for each company The rate of fees for use of system when the number of user IDs of an operational user is six (6) or more: a. Rate applicable to five user IDs of them; JPY 10,000 per month, for each company b. Rate applicable to the number of user IDs in excess of five (5); JPY 1,000 per month, for each user ID in excess of five (5).
Fixed fees to be borne by Indirect Account Management Institutions	Parties approved as Indirect Account Management Institutions	Processing of the approval as Indirect Account Management Institutions	JPY 50,000, for each approval

Source: Japan Securities Depository Center, Inc.

Table 7.3 Short-Term Corporate Bonds-Book-Entry Transfer Businesses

Item of Service Fees	Parties to Pay	Service Contents	Rates
New record service fees	Issuers relating to the new record	Administration of the Information of the Issue and administration of the balance of issue from the time of issuance until the time of redemption	JPY 0.19 per 10,000 for JPY 1 of the subscription price (for each issue), for each subscription (annualized rate)  The monthly amount shall be equal to the amount calculated based on the annualized service fee rate set forth above, multiplied by the number of calendar days during the issue period (including the Issue Date but excluding the Redemption Date) and divided by 365; provided, however, that, if the foregoing amount exceeds JPY 100,000, the monthly amount shall be JPY 100,000.
Book-entry transfer service fees	Issuers and Purchaser JASDEC Participants relating to the new record	Processing for increasing the details recorded in the Transfer Account Book	In the case of the DVP Settlement: JPY 100 per transaction
			In the case of the Non-DVP Settlement: JPY 50 per transaction

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Table 7.3 continuation

Item of Service Fees	Parties to Pay	Service Contents	Rates
	Transferor JASDEC Participants and Transferee JASDEC Participants relating to the book-entry transfer	Processing for changing the details recorded in the Transfer Account Book	In the case of the DVP Settlement: JPY 100 per transaction Provided, however, that the rate of fees for the book-entry transfer implemented between the Classified Accounts of the same JASDEC Participant shall be JPY 50 per transaction.
			In the case of the Non-DVP Settlement: JPY 50 per transaction Provided, however, that the rate of fees for the book-entry transfer implemented between the Classified Accounts of the same JASDEC Participant shall be JPY 25 per transaction.
	Issuers and Obliteration Applicant JASDEC Participants relating to the obliteration	Processing for decreasing the details recorded in the Transfer Account Book	In the case of the DVP Settlement: JPY 100 per transaction
			In the case of the Non-DVP Settlement: JPY 50 per transaction
Purchase and cancellation service fees	Purchase and Cancellation Applicant JASDEC Participants	Processing for decreasing the balance in the Transfer Account Book through purchase and cancellation	JPY 50 per transaction
Account balance administration service fees	JASDEC Participants	Administration of the Transfer Account Book during the holding period	JPY 0.065 per 10,000 for JPY 1 of the monthly average account balance, for each JASDEC Participant (annualized rate)  The monthly amount shall be equal to the amount calculated based on the annualized service fee rate set forth above, multiplied by the number of calendar days during the applicable month and divided by 365.

Source: Japan Securities Depository Center, Inc.

Table 7.4 Corporate Bonds-Participation in the System

Item of Service Fees	Parties to Pay	Service Contents	Rates
Account opening fees and system connection preparation fees	JASDEC Participants	Processing for opening accounts and setting up a system connection	(1) In the case where a party to pay newly becomes a JASDEC Participant: JPY 200,000  Provided, however, that, when two (2) or more sets ( <i>kumi</i> ) of the Classified Accounts are opened with the same account name, the account opening fees and system connection preparation fees shall be JPY 200,000, increased by the amount calculated based on the rate set forth in (2) below for each set ( <i>kumi</i> ) of the Classified Accounts in excess of one (1). In such case, Trust Account (1), Trust Account (2), Trust Account (3), Trust Account (4) and Trust Account (5) (hereinafter referred to as "Each Trust Account in the Holding Account") and Customer Account and Non-resident, Etc. Account (hereinafter referred to as "Customer Account, Etc.") shall be treated as having the same account name.
			(2) In the case where Classified Accounts are opened (excluding the cases falling under (1) above):  JPY 50,000 per set ( <i>kumi</i> )  Provided, however, that, when Classified Accounts are opened with the same account name for the first time, the account opening fees and system connection preparation fees shall be the amount calculated on JPY 50,000 per set ( <i>kumi</i> ) of the Classified Accounts to be opened, minus JPY 50,000. In such case, Each Trust Account in the Holding Account and the Customer Account, Etc. shall be treated as having the same account name.
System connection preparation fees	Parties appointed as the Issuing Agents and the Paying Agents	Processing for setting up a system connection	JPY 50,000

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Table 7.4 continuation

Item of Service Fees	Parties to Pay	Service Contents	Rates
Terminal connection fees	All users of the Integrated Web Terminal (excluding Fund Settlement Corporations)	Use of system resources through a continuous terminal connection	The rate of fees for use of system when the number of user IDs of an operational user is one (1) or more but not more than five (5): JPY 10,000 per month, for each company
			The rate of fees for use of system when the number of user IDs of an operational user is six (6) or more: a. Rate applicable to five user IDs of them; JPY 10,000 per month, for each company b. Rate applicable to the number of user IDs in excess of five (5); JPY 1,000 per month, for each user ID in excess of five (5)
Fixed fees to be borne by Indirect Account Management Institutions	Parties approved as Indirect Account Management Institutions	Processing of the approval as Indirect Account Management Institutions	JPY 50,000, for each approval

Source: Japan Securities Depository Center, Inc.

Table 7.5 Corporate Bonds-Book-Entry Transfer Businesses

Item of Service Fees	Parties to Pay	Service Contents	Rates
New record service fees	Issuers relating to the new record	(i) Administration of the Information of the Issue, (ii) administration of balance and (iii) notice to Paying Agents of information concerning the redemption and interest payment, from the issuance until the redemption	With respect to the total issue amount of each issue: (1) Rate applicable to the portion equal to or less than JPY 100,000,000: JPY 0.95 per 10,000 for JPY 1 (2) Rate applicable to the portion equal to or more than JPY 100,000,001 and less than or equal to JPY 500,000,000: 80% of the rate set forth in (1) above (3) Rate applicable to the portion equal to or more than JPY 500,000,001 and less than or equal to JPY 1,000,000,000: 60% of the rate set forth in (1) above (4) Rate applicable to the portion equal to or more than JPY 1,000,000,001 and less than or equal to JPY 5,000,000,000: 40% of the rate set forth in (1) above (5) Rate applicable to the portion equal to or more than JPY 5,000,000,001 and less than or equal to JPY 10,000,000,000: 20% of the rate set forth in (1) above (6) Rate applicable to the portion equal to or more than JPY 10,000,000,001 and less than or equal to JPY 50,000,000,000: 10% of the rate set forth in (1) above (7) Rate applicable to the portion equal to or more than JPY 50,000,000,001 and less than or equal to JPY 100,000,000,000: 5% of the rate set forth in (1) above (8) Rate applicable to the portion equal to or more than JPY 100,000,000,001: 2.5% of the rate set forth in (1) above
Book-entry transfer service fees	Transferor JASDEC Participants and Transferee JASDEC Participants relating to the book-entry transfer	Processing for changing the details recorded in the Transfer Account Book	In the case of the DVP Settlement: JPY 100 per transaction Provided, however, that the rate of service fees for the book-entry transfer implemented between the Classified Accounts of the same JASDEC Participant shall be JPY 50 per transaction. In the case of the Non-DVP Settlement: JPY 50 per transaction Provided, however, that the rate of service fees for the book-entry transfers implemented between the Classified Accounts of the same JASDEC Participant shall be JPY 25 per transaction.
Purchase and cancellation service fees	Purchase and Cancellation Applicant JASDEC Participants	Processing for decreasing the balance under the Transfer Account Book through purchase and cancellation	JPY 50 per transaction

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Table 7.5 continuation

Item of Service Fees	Parties to Pay	Service Contents	Rates
Account balance administration service fees	JASDEC Participants	Administration of the Transfer Account Book during the holding period	<p>With respect to the monthly average account balance for each JASDEC Participant: (annualized rate)</p> <p>(1) Rate applicable to the portion equal to or less than JPY 500,000,000,000: JPY 0.065 per 10,000 for JPY 1</p> <p>(2) Rate applicable to the portion equal to or more than JPY 500,000,000,001 and less than or equal to JPY 1,000,000,000,000: 60% of the rate set forth in (1) above</p> <p>(3) Rate applicable to the portion equal to or more than JPY 1,000,000,000,001 and less than or equal to JPY 5,000,000,000,000: 40% of the rate set forth in (1) above</p> <p>(4) Rate applicable to the portion equal to or more than JPY 5,000,000,000,001 and less than or equal to JPY 10,000,000,000,000: 20% of the rate set forth in (1) above</p> <p>(5) Rate applicable to the portion equal to or more than JPY 10,000,000,000,001 and less than or equal to JPY 20,000,000,000,000: 10% of the rate set forth in (1) above</p> <p>(6) Rate applicable to the portion equal to or more than JPY 20,000,000,000,001 and less than or equal to JPY 30,000,000,000,000: 5% of the rate set forth in (1) above</p> <p>(7) Rate applicable to the portion equal to or more than JPY 30,000,000,000,001: 2.5% of the rate set forth in (1) above</p> <p>The monthly amount shall be equal to the amount calculated based on the annualized service fee rates set forth above, multiplied by the number of calendar days during the applicable month and divided by 365; provided, however, that, if the foregoing amount is less than JPY 100,000, the monthly amount shall be JPY 100,000.</p>
Portion			Rate and Amount
1.	Equal to or less than ¥100 million:		¥0.95 per 10,000 for ¥1 (Max: ¥9,500)
2.	Equal to or more than ¥100,000,001 and less than or equal to ¥500 million		80% of the rate set forth in (1) above (Max: ¥38,000)
3.	Equal to or more than ¥500,000,001 and less than or equal to ¥1 billion		60% of the rate set forth in (1) above (Max: ¥57,000)
4.	Equal to or more than ¥1,000,000,001 and less than or equal to ¥5 billion		40% of the rate set forth in (1) above (Max: ¥190,000)
5.	Equal to or more than ¥5,000,000,001 and less than or equal to ¥10 billion		20% of the rate set forth in (1) above (Max: ¥190,000)
6.	Equal to or more than ¥10,000,000,001 and less than or equal to ¥50 billion		10% of the rate set forth in (1) above (Max: ¥475,000)
7.	Equal to or more than ¥50,000,000,001 and less than or equal to ¥100 billion		5% of the rate set forth in (1) above (Max: ¥475,000)
8.	Equal to or more than ¥100,000,000,001		2.5% of the rate set forth in (1) above (Minimum: ¥237,500)
Source: Japan Securities Depository Center, Inc.			

## C. Fee to the Fiscal Agent and/or Paying Agent

**Table 7.6 Standard Fee Rate for Fiscal Agent and/or Paying Agent**

Fee Item	Portion/Rating	Rate
1. Coupon Payment Fee (one time: twice a year)	Total Outstanding Amounts	¥0.075 per 10,000 for ¥1
2. Redemption Fee	Total Redemption Amounts	¥0.075 per 10,000 for ¥1
3. Paying Agent for CP issuance and redemption	Per one payment	Several thousand yen per one issue/redemption
4. Agent Fee related to Bonds		
a. Fiscal Agent Annual Fee (Yearly) (Outstanding amount)	Total Outstanding Amounts (¥10 billion)	¥0.075 per 10,000 for ¥1 (¥75,000)
a. CCB (Commissioned Company for Bondholders) Fee	-AA	1 basis point (bp)/p.a. x Outstanding Amount
	A	2 bps/p.a. x Outstanding Amount
	BBB	4.5 bps/p.a. x Outstanding Amount
In case of the CCB attached bonds, both of above fees (a. + b.) will be charged.		
Source: ABMF-J Member.		

## D. Standard Fiscal Agent Fee for Public Offering of Corporate Bonds

**Table 7.7 Standard Fiscal Agent Fee for Public Offering of Corporate Bond**

Maturity	Total Payable Amount in Case of Bond Size ¥10 billion
3 years	¥12 million
5 years	¥13 million
7 years	¥14 million
Source: ABMF-J Member.	

## E. Others

**Table 7.8 Other Fees and Costs**

Item	Details
1. Credit Rating Fee	Credit rating fee will vary greatly depending on the target, content and the size.
2. Stamp Duty	The buyer pays a stamp duty of ¥200 per trade for physical certificate transfers. JASDEC-held securities are exempt from stamp duty.
3. Registration Costs	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 ¥800 to ¥1200 for registration per transaction.
Source: ABMF-J Member.	

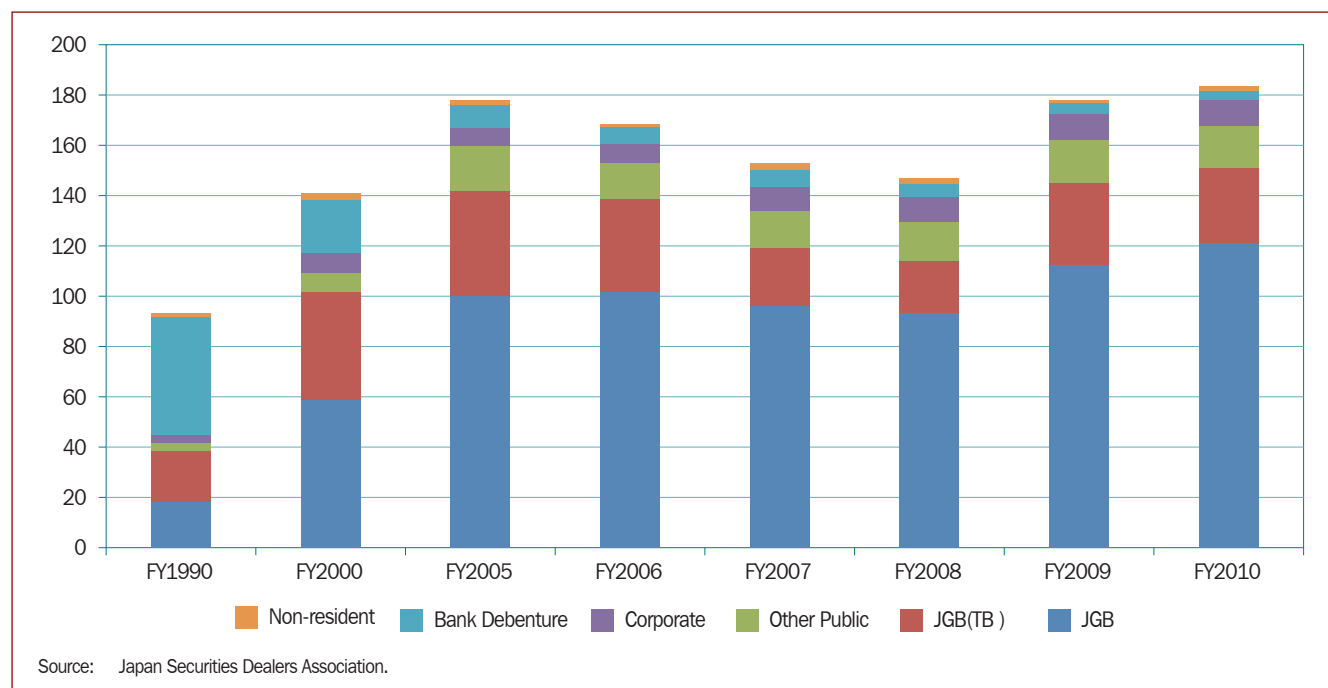
# VIII. Market Statistics

## A. Overview

The total value of public and corporate bonds issued in fiscal 2010 (ending 31 March 2011) was ¥183.7 trillion. Of this amount, ¥151.1 trillion, or 82% 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 2008, Japanese government bond (JGB) issuance had been on the decline along with the upswing in the central government’s financial position, but issuance mounts again given the deterioration in the government’s finances caused by the slump in the economy following the Lehman Shock in September 2008.

**Figure 8.1 Issuance of Bonds by Type, FY 1990 to FY 2010 (¥ trillion)**





**Table 8.1 Issuance of Bonds by Type, FY 1990 to FY 2010 (¥ trillion)**

	FY1990	FY2000	FY2005	FY2006	FY2007	FY2008	FY2009	FY2010
JGB	18.3	58.8	100.1	101.8	96.4	93.2	112.4	121.1
JGB(TB )	20.5	42.8	41.9	36.8	22.8	21.0	32.9	30.0
Other Public	2.9	7.5	17.9	14.6	15.0	15.3	16.8	16.7
Corporate	3.4	8.3	7.4	7.5	9.6	9.9	10.6	10.1
Bank Debenture	46.9	21.0	8.8	6.7	6.5	5.5	4.2	3.8
Non-resident	1.4	2.6	1.6	0.8	2.6	2.1	1.2	1.9
Total	93.2	141.0	177.6	168.1	152.9	147.0	178.1	183.7
Notes: Other Public includes local government bonds and government agency bonds. Corporate etc. includes asset-backed bonds and convertible-type bonds.								
Source: Japan Securities Dealers Association.								

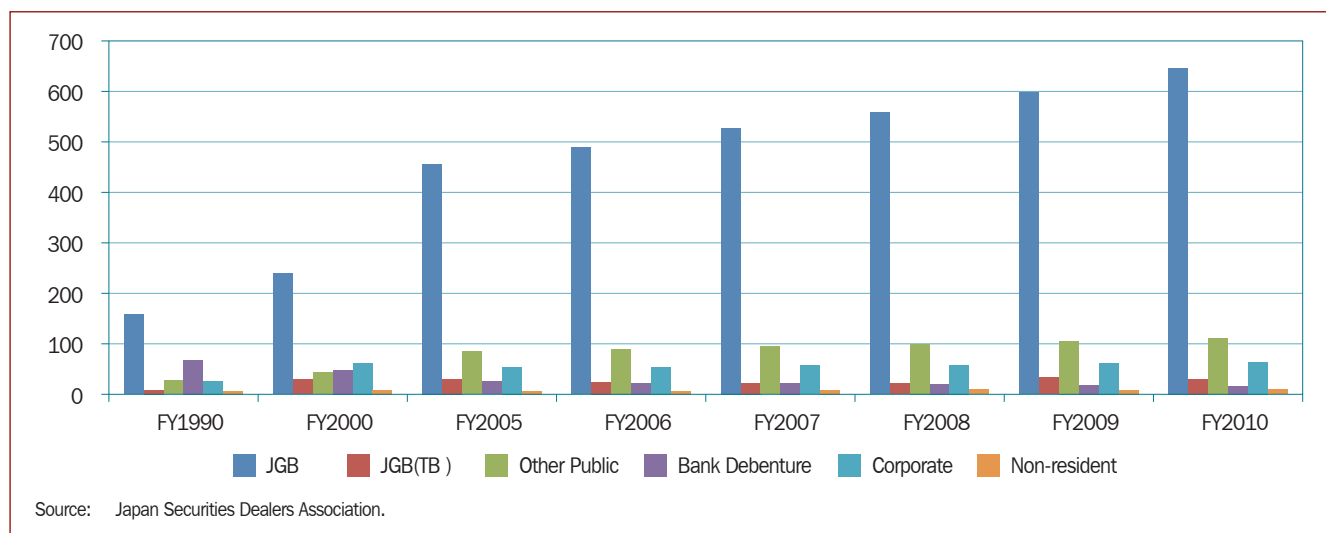
The amount of bank debentures issued in fiscal 2010 stood at ¥3.8 trillion, down largely from ¥46.9 trillion in fiscal 1990. This market movement suggests that the Japanese industry's dependency on long-term credit banks as a source of long-term capital has come to an end.

The total issue value of corporate bonds reached ¥10.1 trillion in fiscal 2010, keeping almost the same level for 4 consecutive years but occupying only 5.5% of the total bond issue value. The dematerialization of bonds issued in Japan put a temporary halt in the issuing market in 2006.

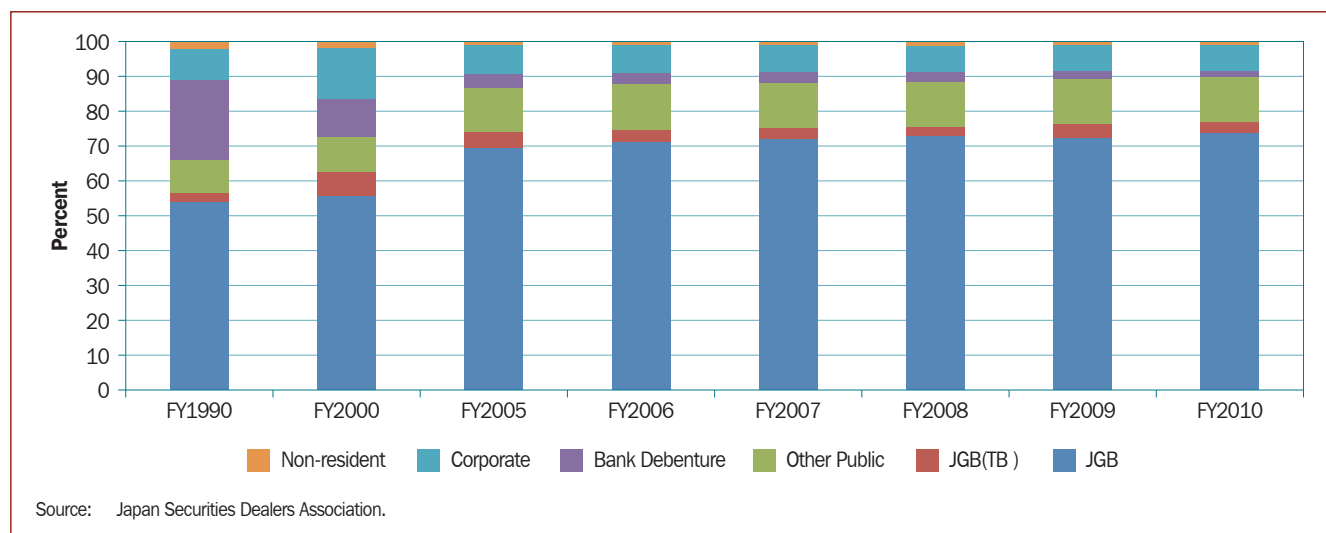
Meanwhile, once depressed in the aftermath of default on Argentine government debt in 2002, the issuance of yen-denominated foreign bonds was steadily recovering. Thereafter with certain ups and downs, the yen-denominated foreign bonds continue to be used as an important financing source for foreign issuers supported by their needs for the diversification of the currency risk in bond issuance. And because of a measure for credit enhancement called "GATE," which the Japan Bank for International Cooperation (JBIC) introduced in April 2010 to facilitate the new Samurai Bond issues, the total issue value of yen-denominated foreign bonds recovered to ¥1.9 trillion in fiscal 2010.

## B. Outstanding Amount of Bonds Issued in Japan

**Figure 8.2 Outstanding Amount of Bonds (¥ trillion)**



**Figure 8.3 Outstanding Amount of Bonds (Percentage)**



**Table 8.2 Outstanding Amount of Bonds, FY 1990 to FY 2010 (¥ trillion)**

	FY1990	FY2000	FY2005	FY2006	FY2007	FY2008	FY2009	FY2010
JGB	158.1	239.6	455.7	488.8	527.5	558.0	598.2	646.8
JGB (TB)	8.2	29.6	29.9	24.8	22.8	21.0	32.9	30.0
Other Public	27.1	42.9	84.5	89.2	94.4	99.1	105.8	111.5
Bank Debenture	67.7	48.2	25.5	22.9	22.0	20.9	18.9	16.7
Corporate etc.	26.0	61.9	54.5	54.3	56.7	58.1	61.4	64.0
Non-resident	6.0	8.2	6.7	6.5	8.1	9.3	9.0	9.5
<b>Total</b>	<b>293.1</b>	<b>430.5</b>	<b>656.9</b>	<b>686.6</b>	<b>731.5</b>	<b>766.4</b>	<b>826.3</b>	<b>878.5</b>

Source: Japan Securities Dealers Association.

## C. Size of Local Currency Bond Market in U.S. Dollars

**Table 8.3 Size of LCY Bond Market in USD (Local Sources)**

Date	Govt (in USD Billions)	Corp (in USD Billions)	Total (in USD Billions)
Mar-98	2210.77	955.72	3166.49
Jun-98	2152.91	913.75	3066.66
Sep-98	2245.23	918.95	3164.18
Dec-98	2763.54	1093.59	3857.13
Mar-99	2774.72	1030.72	3805.44
Jun-99	2786.00	1020.99	3806.99
Sep-99	3243.76	1164.64	4408.41
Dec-99	3481.93	1209.39	4691.33
Mar-00	3593.62	1194.70	4788.32
Jun-00	3543.20	1151.18	4694.38
Sep-00	3576.00	1123.70	4699.71
Dec-00	3499.39	1053.14	4552.53
Mar-01	3249.07	936.77	4185.85
Jun-01	3429.45	953.91	4383.36
Sep-01	3724.84	980.42	4705.26
Dec-01	3529.78	882.27	4412.05
Mar-02	3646.14	844.37	4490.51
Jun-02	4195.30	924.39	5119.70
Sep-02	4255.01	889.03	5144.05
Dec-02	4503.57	897.54	5401.11
Mar-03	4670.36	875.34	5545.70
Jun-03	4724.96	852.10	5577.06
Sep-03	5221.11	885.71	6106.82
Dec-03	5541.83	907.14	6448.96
Mar-04	5883.32	913.25	6796.57
Jun-04	5807.90	864.38	6672.27
Sep-04	5906.54	835.63	6742.17
Dec-04	6556.28	891.14	7447.42
Mar-05	6497.34	831.55	7328.89
Jun-05	6426.45	792.01	7218.46
Sep-05	6389.37	769.63	7159.00
Dec-05	6301.63	743.68	7045.31
Mar-06	6374.52	736.68	7111.20
Jun-06	6547.67	749.03	7296.70
Sep-06	6405.61	713.58	7119.19
Dec-06	6389.38	706.94	7096.32
Mar-07	6448.51	710.78	7159.29
Jun-07	6153.55	688.45	6842.01
Sep-07	6639.39	746.86	7386.25
Dec-07	6874.22	773.10	7647.32
Mar-08	7779.36	870.14	8649.50
Jun-08	7319.51	822.76	8142.27
Sep-08	7291.62	826.60	8118.22

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Table 8.3 continuation

Date	Govt (in USD Billions)	Corp (in USD Billions)	Total (in USD Billions)
Dec-08	8564.36	963.19	9527.55
Mar-09	7842.17	892.41	8734.58
Jun-09	8112.59	921.42	9034.01
Sep-09	8827.21	1001.28	9828.49
Dec-09	8655.57	964.17	9619.74
Mar-10	8794.24	956.15	9750.39
Jun-10	9465.66	1014.24	10479.90
Sep-10	10134.24	1076.72	11210.96
Dec-10	10605.84	1112.95	11718.78
Mar-11	10418.08	1085.63	11503.71
Jun-11	10887.29	1103.96	11991.25

Source: Asian Development Bank, AsianBondsOnline. [http://asianbondsonline.adb.org/japan/data/bondmarket.php?code=LCY\\_in\\_USD\\_Local](http://asianbondsonline.adb.org/japan/data/bondmarket.php?code=LCY_in_USD_Local)

## D. Size of Local Currency Bond Market in Percentage of Gross Domestic Product

Table 8.4 Size of Local Currency Bond Market (Local Sources) (% GDP)

Date	Govt (in %GDP)	Corp (in %GDP)	Total (in %GDP)	Govt (in USD Billions)	Corp (in USD Billions)	Total (in USD Billions)
Mar-98	57.3	24.8	82.0	2210.77	955.72	3166.49
Jun-98	58.5	24.8	83.4	2152.91	913.75	3066.66
Sep-98	60.3	24.7	85.0	2245.23	918.95	3164.18
Dec-98	62.2	24.6	86.8	2763.54	1093.59	3857.13
Mar-99	65.5	24.3	89.9	2774.72	1030.72	3805.44
Jun-99	67.2	24.6	91.8	2786.00	1020.99	3806.99
Sep-99	69.0	24.8	93.8	3243.76	1164.64	4408.41
Dec-99	71.7	24.9	96.6	3481.93	1209.39	4691.33
Mar-00	73.9	24.6	98.5	3593.62	1194.70	4788.32
Jun-00	75.2	24.4	99.6	3543.20	1151.18	4694.38
Sep-00	77.0	24.2	101.3	3576.00	1123.70	4699.71
Dec-00	79.6	24.0	103.6	3499.39	1053.14	4552.53
Mar-01	81.4	23.5	104.9	3249.07	936.77	4185.85
Jun-01	84.9	23.6	108.5	3429.45	953.91	4383.36
Sep-01	88.8	23.4	112.1	3724.84	980.42	4705.26
Dec-01	93.4	23.3	116.7	3529.78	882.27	4412.05
Mar-02	98.0	22.7	120.7	3646.14	844.37	4490.51
Jun-02	102.0	22.5	124.5	4195.30	924.39	5119.70
Sep-02	105.5	22.0	127.6	4255.01	889.03	5144.05
Dec-02	108.9	21.7	130.6	4503.57	897.54	5401.11
Mar-03	112.6	21.1	133.7	4670.36	875.34	5545.70
Jun-03	115.5	20.8	136.3	4724.96	852.10	5577.06
Sep-03	118.8	20.2	139.0	5221.11	885.71	6106.82
Dec-03	121.2	19.8	141.0	5541.83	907.14	6448.96
Mar-04	124.2	19.3	143.5	5883.32	913.25	6796.57
Jun-04	127.4	19.0	146.4	5807.90	864.38	6672.27

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Table 8.4 continuation

Date	Govt (in %GDP)	Corp (in %GDP)	Total (in %GDP)	Govt (in USD Billions)	Corp (in USD Billions)	Total (in USD Billions)
Sep-04	130.6	18.5	149.1	5906.54	835.63	6742.17
Dec-04	135.0	18.4	153.4	6556.28	891.14	7447.42
Mar-05	139.7	17.9	157.5	6497.34	831.55	7328.89
Jun-05	142.7	17.6	160.2	6426.45	792.01	7218.46
Sep-05	144.9	17.5	162.4	6389.37	769.63	7159.00
Dec-05	147.9	17.5	165.3	6301.63	743.68	7045.31
Mar-06	149.2	17.2	166.5	6374.52	736.68	7111.20
Jun-06	148.6	17.0	165.6	6547.67	749.03	7296.70
Sep-06	149.8	16.7	166.5	6405.61	713.58	7119.19
Dec-06	149.9	16.6	166.5	6389.38	706.94	7096.32
Mar-07	148.7	16.4	165.1	6448.51	710.78	7159.29
Jun-07	147.7	16.5	164.2	6153.55	688.45	6842.01
Sep-07	148.1	16.7	164.8	6639.39	746.86	7386.25
Dec-07	149.0	16.8	165.8	6874.22	773.10	7647.32
Mar-08	150.4	16.8	167.2	7779.36	870.14	8649.50
Jun-08	151.4	17.0	168.4	7319.51	822.76	8142.27
Sep-08	151.7	17.2	168.9	7291.62	826.60	8118.22
Dec-08	153.9	17.3	171.2	8564.36	963.19	9527.55
Mar-09	157.7	17.9	175.7	7842.17	892.41	8734.58
Jun-09	161.7	18.4	180.1	8112.59	921.42	9034.01
Sep-09	166.4	18.9	185.2	8827.21	1001.28	9828.49
Dec-09	171.0	19.0	190.0	8655.57	964.17	9619.74
Mar-10	173.4	18.9	192.3	8794.24	956.15	9750.39
Jun-10	176.1	18.9	195.0	9465.66	1014.24	10479.90
Sep-10	176.9	18.8	195.7	10134.24	1076.72	11210.96
Dec-10	179.5	18.8	198.4	10605.84	1112.95	11718.78
Mar-11	182.0	19.0	201.0	10418.08	1085.63	11503.71
Jun-11	185.8	18.8	204.7	10887.29	1103.96	11991.25

Source: Asian Development Bank, AsianBondsOnline, [http://asianbondsonline.adb.org/japan/data/bondmarket.php?code=LCY\\_in\\_GDP\\_Local](http://asianbondsonline.adb.org/japan/data/bondmarket.php?code=LCY_in_GDP_Local)

## E. Size of Foreign Currency Bond Market in U.S. Dollars (Bank for International Settlement)

Table 8.5 Foreign Currency Bonds (BIS) (\$ billions)

Date	FCY Denominated Bonds (in USD billions)
Dec-95	230.4
Dec-96	197.4
Dec-97	155.0
Dec-98	132.9
Dec-99	124.7
Dec-00	105.0
Dec-01	95.2
Dec-02	104.2
Dec-03	119.5
Mar-04	125.5

continued on next page

Table 8.5 continuation

Date	FCY Denominated Bonds (in USD billions)
Jun-04	131.5
Sep-04	131.2
Dec-04	141.1
Mar-05	141.1
Jun-05	139.7
Sep-05	143.5
Dec-05	140.1
Mar-06	144.8
Jun-06	149.9
Sep-06	149.4
Dec-06	151.2
Mar-07	150.7
Jun-07	149.6
Sep-07	157.8
Dec-07	164.1
Mar-08	179.8
Jun-08	177.4
Sep-08	175.7
Dec-08	185.2
Mar-09	169.2
Jun-09	167.7
Sep-09	174.4
Dec-09	170.6
Mar-10	171.1
Jun-10	168.0
Sep-10	182.5
Dec-10	183.6
Mar-11	184.6

Source: Asian Development Bank, AsianBondsOnline. [http://asianbondsonline.adb.org/japan/data/bondmarket.php?code=FCY\\_in\\_USD](http://asianbondsonline.adb.org/japan/data/bondmarket.php?code=FCY_in_USD)

## F. Size of FCY Bond Market in Percentage of Gross Domestic Product (Bank for International Settlement)

Table 8.6 Foreign Currency Bonds to Gross Domestic Product Ratio

Date	as % of GDP	FCY Denominated Bonds (in USD billions)	GDP (in USD billions)
Dec-95	4.8	230.4	4768.5
Dec-96	4.5	197.4	4350.8
Dec-97	3.9	155.0	3946.2
Dec-98	3.0	132.9	4444.6
Dec-99	2.6	124.7	4854.4
Dec-00	2.4	105.0	4396.4
Dec-01	2.5	95.2	3780.3

continued on next page

Table 8.6 continuation

Date	as % of GDP	FCY Denominated Bonds (in USD billions)	GDP (in USD billions)
Dec-02	2.5	104.2	4136.0
Dec-03	2.6	119.5	4572.8
Mar-04	2.6	125.5	4737.6
Jun-04	2.9	131.5	4557.2
Sep-04	2.9	131.2	4522.0
Dec-04	2.9	141.1	4855.6
Mar-05	3.0	141.1	4652.3
Jun-05	3.1	139.7	4504.8
Sep-05	3.3	143.5	4408.5
Dec-05	3.3	140.1	4261.0
Mar-06	3.4	144.8	4272.3
Jun-06	3.4	149.9	4406.3
Sep-06	3.5	149.4	4276.2
Dec-06	3.5	151.2	4261.8
Mar-07	3.5	150.7	4336.2
Jun-07	3.6	149.6	4165.9
Sep-07	3.5	157.8	4482.3
Dec-07	3.6	164.1	4613.2
Mar-08	3.5	179.8	5174.1
Jun-08	3.7	177.4	4835.4
Sep-08	3.7	175.7	4807.2
Dec-08	3.3	185.2	5564.6
Mar-09	3.4	169.2	4972.4
Jun-09	3.3	167.7	5017.3
Sep-09	3.3	174.4	5305.2
Dec-09	3.4	170.6	5062.2
Mar-10	3.4	171.1	5071.5
Jun-10	3.1	168.0	5375.5
Sep-10	3.2	182.5	5729.5
Dec-10	3.1	183.6	5907.5
Mar-11	3.2	184.6	5722.8

Source: Asian Development Bank, AsianBondsOnline, [http://asianbondsonline.adb.org/japan/data/bondmarket.php?code=FCY\\_in\\_GDP](http://asianbondsonline.adb.org/japan/data/bondmarket.php?code=FCY_in_GDP)

## G. Size of Foreign Currency Bond Market in U.S. Dollars (Local Sources)

Table 8.7 Foreign Currency Bonds Outstanding (Local Sources) (\$ billions)

Date	Government	Banks and Financial Institutions	Other Corporates	Total Foreign Currency
Mar-04	25.11	10.48	16.92	52.51
Jun-04	26.23	10.28	18.84	55.35
Sep-04	24.79	10.51	17.70	52.99
Dec-04	25.77	9.98	18.41	54.16
Mar-05	24.58	10.95	17.77	53.30
Jun-05	25.32	10.44	17.16	52.91

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Table 8.7 continuation

Date	Government	Banks and Financial Institutions	Other Corporates	Total Foreign Currency
Sep-05	24.57	16.97	16.33	57.87
Dec-05	24.73	18.17	15.93	58.84
Mar-06	25.04	24.91	16.77	66.72
Jun-06	25.47	26.14	16.28	67.89
Sep-06	25.41	31.40	14.28	71.09
Dec-06	23.68	38.08	15.52	77.28
Mar-07	24.50	40.57	13.33	78.40
Jun-07	25.11	42.33	12.44	79.87
Sep-07	24.21	43.60	12.05	79.86
Dec-07	25.63	43.66	11.89	81.19
Mar-08	27.33	44.80	11.56	83.69
Jun-08	27.38	46.48	11.49	85.35
Sep-08	25.61	45.90	10.32	81.83
Dec-08	25.51	44.24	9.92	79.67
Mar-09	24.40	45.48	9.46	79.34
Jun-09	26.54	47.27	8.78	82.60
Sep-09	26.86	48.42	8.98	84.26
Dec-09	28.21	49.92	8.96	87.09
Mar-10	29.24	25.45	6.56	61.25
Jun-10	30.48	57.95	8.41	96.84
Sep-10	29.94	58.91	17.15	106.01
Dec-10	29.83	58.03	19.54	107.40
Mar-11	33.59	70.85	7.31	111.75

Source: Asian Development Bank, AsianBondsOnline, [http://asianbondsonline.adb.org/japan/data/bondmarket.php?code=FCY\\_Bonds\\_Outstanding](http://asianbondsonline.adb.org/japan/data/bondmarket.php?code=FCY_Bonds_Outstanding)

## H. Foreign Holdings in Local Currency Government Bonds

Table 8.8 Foreign Holdings in LCY Government Bonds (¥ billions)

Date	Foreign Holdings	Total	% of Total
Mar-98	18329.8	299330.9	6.12
Jun-98	20168.6	304280.9	6.63
Sep-98	22855.7	322506.1	7.09
Dec-98	27311.6	319853.5	8.54
Mar-99	27388.0	339031.7	8.08
Jun-99	22255.0	340901.1	6.53
Sep-99	22679.8	351270.9	6.46
Dec-99	18355.3	358662.7	5.12
Mar-00	18518.7	366534.6	5.05
Jun-00	23578.8	371657.8	6.34
Sep-00	25216.5	376972.5	6.69
Dec-00	23262.8	391080.7	5.95
Mar-01	24287.4	408789.0	5.94
Jun-01	23826.0	425186.1	5.60
Sep-01	22495.9	436887.9	5.15

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Table 8.8 continuation

Date	Foreign Holdings	Total	% of Total
Dec-01	21596.4	451665.3	4.78
Mar-02	16539.3	469271.7	3.52
Jun-02	17259.1	487917.4	3.54
Sep-02	18181.9	504534.8	3.60
Dec-02	16812.8	519791.5	3.23
Mar-03	17407.2	537762.7	3.24
Jun-03	16903.8	546794.8	3.09
Sep-03	14527.0	545420.9	2.66
Dec-03	16708.1	556416.9	3.00
Mar-04	19648.9	570718.7	3.44
Jun-04	19856.6	577944.7	3.44
Sep-04	23468.5	599219.8	3.92
Dec-04	25668.6	618862.3	4.15
Mar-05	26386.5	641809.7	4.11
Jun-05	30392.9	659216.6	4.61
Sep-05	29455.9	658626.5	4.47
Dec-05	31331.5	672305.7	4.66
Mar-06	30231.9	667328.0	4.53
Jun-06	34899.0	658792.1	5.30
Sep-06	34473.0	674981.4	5.11
Dec-06	37325.8	675523.0	5.53
Mar-07	40208.2	672703.0	5.98
Jun-07	37114.5	660587.1	5.62
Sep-07	41063.0	669646.6	6.13
Dec-07	47931.3	682772.3	7.02
Mar-08	47372.7	694998.4	6.82
Jun-08	48006.2	683680.6	7.02
Sep-08	52928.9	682108.3	7.76
Dec-08	44990.5	696747.9	6.46
Mar-09	43949.5	680869.8	6.45
Jun-09	41357.5	674845.3	6.13
Sep-09	39647.0	678676.6	5.84
Dec-09	34673.8	679311.8	5.10
Mar-10	31631.4	682052.1	4.64
Jun-10	32951.8	708486.0	4.65
Sep-10	37049.4	725748.4	5.10
Dec-10	35918.4	727959.6	4.93
Mar-11	36510.6	726268.0	5.03

Source: Asian Development Bank, AsianBondsOnline. [http://asianbondsonline.adb.org/japan/data/bondmarket.php?code=Foreign\\_Holdings](http://asianbondsonline.adb.org/japan/data/bondmarket.php?code=Foreign_Holdings)

## I. Domestic Financing Profile

**Table 8.9 Domestic Financing Profile**

Date	Domestic Credit (% of Total)	Bonds (% of Total)	Equity (% of Total)	Domestic Credit (in \$ billions)	Bonds (in \$ billions)	Equity (in \$ billions)	Total (in \$ billions)
Dec-00	0	59.05	40.95	0	4552.53	3157.22	7709.75
Dec-01	57.60	28.02	14.38	9069.83	4412.05	2264.53	15746.41
Dec-02	56.70	31.31	11.99	9781.71	5401.11	2069.30	17252.12
Dec-03	53.71	31.75	14.54	10910.66	6448.97	2953.10	20312.73
Dec-04	50.61	33.43	15.97	11275.46	7447.42	3557.67	22280.55
Dec-05	45.71	32.92	21.37	9782.90	7045.31	4572.90	21401.11
Dec-06	44.49	33.64	21.87	9387.00	7096.32	4614.07	21097.39
Mar-07	44.40	33.46	22.14	9501.32	7159.29	4737.54	21398.15
Jun-07	43.67	33.45	22.88	8933.79	6842.00	4681.05	20456.84
Sep-07	44.40	34.35	21.25	9546.21	7386.25	4569.15	21501.62
Dec-07	44.92	35.16	19.91	9769.09	7647.32	4330.92	21747.33
Mar-08	46.53	36.65	16.83	10981.76	8649.5	3971.39	23602.66
Jun-08	45.58	36.37	18.06	10204.86	8142.27	4042.79	22389.92
Sep-08	47.03	37.55	15.42	10167.38	8118.22	3334.41	21620.01
Dec-08	49.19	38.29	12.52	12239.04	9527.55	3115.80	24882.40
Mar-09	49.39	38.96	11.65	11071.96	8734.58	2610.66	22417.20
Jun-09	48.32	38.15	13.53	11440.95	9034.01	3203.51	23678.47
Sep-09	48.29	38.38	13.33	12366.34	9828.49	3413.35	25608.18
Dec-09	48.29	38.49	13.23	12069.29	9619.74	3306.08	24995.11
Mar-10	47.50	38.53	13.97	12018.87	9750.50	3534.69	25304.06
Jun-10	48.14	39.51	12.36	12768.33	10480.01	3277.30	26525.65
Sep-10	48.20	39.69	12.12	13615.13	11211.08	3423.74	28249.95
Dec-10	47.45	39.62	12.94	14039.00	11722.90	3827.77	29589.68
Mar-11	0	76	24	0	11512.83	3634.79	15147.62

Source: Asian Development Bank, AsianBondsOnline, [http://asianbondsonline.adb.org/japan/data/bondmarket.php?code=Domestic\\_Financing\\_profile](http://asianbondsonline.adb.org/japan/data/bondmarket.php?code=Domestic_Financing_profile)

## J. Trading Volume

**Table 8.10 Trading Volume (\$ billions)**

Year	Govt Bonds	Corp Bonds	Total
Mar-99	2934.45	65.06	2999.51
Jun-99	4448.98	58.39	4507.37
Sep-99	4979.03	69.43	5048.46
Dec-99	4492.24	67.82	4560.06
Mar-00	4306.39	88.56	4394.95
Jun-00	4824.48	106.83	4931.31
Sep-00	4417.15	105.14	4522.29
Dec-00	4704.77	100.88	4805.65
Mar-01	3801.78	111.31	3913.09
Jun-01	4292.83	109.15	4401.98
Sep-01	4096.92	95.11	4192.03
Dec-01	3399.44	122.50	3521.94

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Table 8.10 continuation

Year	Govt Bonds	Corp Bonds	Total
Mar-02	2877.31	122.21	2999.52
Jun-02	3848.96	127.63	3976.59
Sep-02	3780.42	119.53	3899.95
Dec-02	3758.50	131.9	3890.40
Mar-03	4228.12	131.19	4359.31
Jun-03	5348.85	138.46	5487.31
Sep-03	6161.63	150.66	6312.29
Dec-03	6010.11	136.35	6146.46
Mar-04	6572.17	148.55	6720.72
Jun-04	7451.95	158.75	7610.70
Sep-04	7641.00	155.31	7796.31
Dec-04	7933.90	176.57	8110.47
Mar-05	7107.04	156.74	7263.78
Jun-05	7349.86	145.05	7494.91
Sep-05	7445.76	145.11	7590.87
Dec-05	7402.82	130.00	7532.82
Mar-06	8462.15	129.66	8591.81
Jun-06	10361.46	142.38	10503.84
Sep-06	9419.71	96.87	9516.58
Dec-06	10155.32	69.42	10224.74
Mar-07	11305.20	73.00	11378.20
Jun-07	11999.13	77.44	12076.57
Sep-07	13635.97	81.09	13717.06
Dec-07	14489.81	86.45	14576.26
Mar-08	15545.71	100.64	15646.35
Jun-08	14076.61	88.74	14165.35
Sep-08	12547.80	81.20	12629.00
Dec-08	13442.04	113.93	13555.97
Mar-09	11763.39	93.50	11856.89
Jun-09	10908.12	70.85	10978.97
Sep-09	11511.81	58.66	11570.47
Dec-09	10776.30	53.89	10830.19
Mar-10	8984.88	55.33	9040.21
Jun-10	10530.51	84.85	10615.36
Sep-10	11886.53	79.73	11966.26
Dec-10	12122.52	75.81	12198.33
Mar-11	11108.42	75.56	11183.98
Jun-11	12245.31	94.28	12339.59

Source: Asian Development Bank, AsianBondsOnline. [http://asianbondsonline.adb.org/japan/data/bondmarket.php?code=Trading\\_Volume](http://asianbondsonline.adb.org/japan/data/bondmarket.php?code=Trading_Volume)

# IX. Islamic Finance in Japan

## A. Background on Introducing Islamic Finance in Japan

Japan has strong economic ties with Islamic countries, particularly Middle East oil producing countries, which are demonstrated by huge cash outflow from Japan to those countries every year. Facilitating the reverse flow of investment from Islamic countries towards Japan and other Asian regions is very meaningful for a balanced growth of the 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) to invest in Japan by participating in the Islamic Financial Services Board (IFSB), an international standard-setting organization for the Islamic finance services industry headquartered in Kuala Lumpur, Malaysia, as observer (see Table 9.1).

**Table 9.1 Japanese Organizations in the Islamic Financial Services Board**

Name	Nationality	Member Status
Bank of Japan	Japan	Observer Member
Bank of Tokyo-Mitsubishi (Malaysia)	Malaysia	Observer Member
Japan Bank for International Cooperation	Japan	Observer Member
Japan Securities Dealers Association	Japan	Observer Member
Mizuho Corporate Bank	Japan	Observer Member
Nomura Asset Management Malaysia	Malaysia	Observer Member
Nomura Securities	Japan	Observer Member
Sumitomo Mitsui Banking Corporation	Japan	Observer Member
(8 institutions)		

Source: Japan Securities Dealers Association.

In terms of private transactions, 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 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.
2. Daiwa Asset Management arranged the listing of the first Shari'ah compliant exchange-traded fund (ETF) for Japanese stocks in Singapore in 2008.
3. Nomura Holdings issued the first US dollar-denominated *Sukuk al Ijarah* (\$100 million) in July 2010 in Malaysia based on aircraft leasing.
4. Daiwa Securities Capital Markets acted as co-lead arranger for Islamic real-estate investment trusts (REIT) listed on the Singapore Exchange (SGX) in November 2010.

## B. Regulatory Framework for Islamic Finance in General

For the time being, Japan is not equipped with a full-ranged regulatory framework for operating Islamic finance. However, in December 2008, the Japanese banking and insurance business regulation was relaxed to allow subsidiaries of Japanese banks and 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* and the *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, issues of Shari'ah compliance, or that of supervision of the market, have not yet been taken up for discussion in Japan.

## C. Regulatory and Legal Framework for Islamic Bonds (Sukuk)

### 1. Background on the 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. Since the latter half of 2010, the momentum within the governmental agency, Japan Financial Services Agency (J-FSA) became explicit such as:

- a. Recommendation by expert advisory group within J-FSA (July 2010) that “[i]t 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.”  
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);

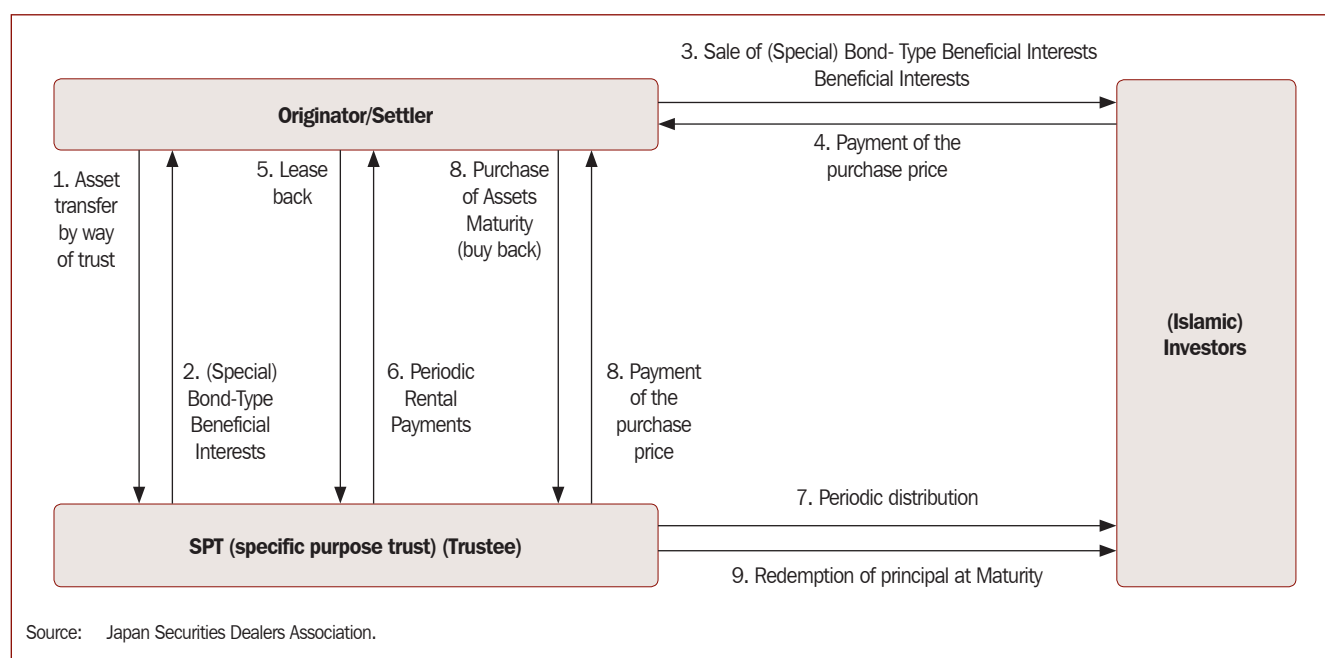
- e. Outline of the tax reform 2011 announced by the government (December 2010) (“Tax Reform Outline 2011”); and
- f. Action Plan for Japan’s New Growth Strategy, announced by the FSA on 24 December 2010: “the FSA will promote the development of the environment for Islamic bond issuance in Japan.”

## 2. Amendment of Legislation for Issuing Sukuk under Japanese Law

Following the momentum described above, National Diet passed a bill on 17 May 2011 to facilitate Sukuk issuance in Japan by way of amendment of the *Asset Securitization Act* (*shisan ryudoka ho* 「資産流動化法」). The bill is accompanied by amendments on relevant tax legislation with a view to creating a level tax playing field compared to conventional bonds.

A bill entitled “The Financial Instruments and Exchange Act (Amendment) for Reinforcement of Infrastructure of the Capital Market and Financial Business” (or the Bill), was presented before the National Diet on 1 April 2011 by the government of Japan. The bill involves an amendment of the *Asset Securitization Act* which anticipates accommodating a legal framework for the issuance of Sukuk, particularly Sukuk Ijarah, in Japan. The Sukuk Ijarah, under the new legal framework, will be established typically by taking the form of (Special) Bond-Type Beneficial Interests (*tokubetu shasai-teki jueki-ken* 「特別社債の受益権」) to be issued under the architecture of a specific purpose trust (*tokutei mokuteki shintaku* 「特定目的信託」) (SPT) pursuant to the amended *Asset Securitization Act*. The outline of the structure is illustrated below; whereby steps are taken in the manner illustrated in Figure 9.1. The (Special) Bond-Type Beneficial Interest is a certain type of beneficial interest under a SPT, for which a predetermined amount of money is distributed and a condition is attached to the effect that the originator shall purchase (buy back) the underlying assets or such other terms to be prescribed in the Cabinet Order.

**Figure 9.1 Issuance Scheme**



- (1) A Japanese institution acting as the originator (or settler in the context of the SPT Agreement) and a trustee, which would typically be a trust bank, enter into a specific purpose trust agreement (SPT Agreement) whereby the originator transfers the ownership of an asset (such as real estate, “Underlying Asset”) to the trustee who holds the same on trust.
- (2) The originator acquires (Special) Bond-Type Beneficial Interests in exchange for the transfer of the Underlying Asset to the trustee pursuant to the SPT Agreement.
- (3) The originator sells the (Special) Bond-Type Beneficial Interests to investors that include Islamic investors.
- (4) Investors pay the amount equivalent to the purchase price for the (Special) Bond-Type Beneficial Interests to the originator.
- (5) The originator enters into an Ijarah lease agreement with the trustee in respect of the Underlying Asset.
- (6) The originator makes periodic rental payments to the trustee under the Ijarah lease agreement.
- (7) The trustee makes periodic distribution of the profit to the investors by way of dividends on the (Special) Bond-Type Beneficial Interests, which are funded by the rental payments under the Ijarah lease agreement.
- (8) At maturity, the originator purchases (buys back) the Underlying Asset at a predetermined price equivalent to the (Special) Bond-Type Beneficial Interests amount then outstanding.
- (9) The trustee redeems the (Special) Bond-Type Beneficial Interests by utilizing the purchase price received from the originator.

In order for an instrument to fall within the definition of the (Special) Bond-Type Beneficial Interests under the new Art. 230 of the *Asset Securitization Act*, it needs to have all the following key characteristics:

- a. Amount of distribution.** The amount of distribution must be set out in the SPT Agreement in the form of a pre-determined amount or such other calculation whose method is to be prescribed in the Cabinet Order, which deems to result a pre-determined amount.<sup>23</sup>
- b. Structure of payments.** The principal must be redeemed at a pre-determined point in time. The payment structure must allow not only payment at the end of the Sukuk term but also in installments.
- c. Voting rights.** The holders of the (Special) Bond-Type Beneficial Interests are not granted voting rights save for prescribed resolutions such as amendment and termination of the SPT Agreement.
- d. Asset-based nature (rather than asset backed).** The credit standing of the originator (i.e., the settler of the SPT) should have a material effect on the investment decision of the investors. On the face of the provision of the *Asset Securitization Act*, the asset-based nature of the (Special) Bond-Type Beneficial Interests is recognized by a purchase undertaking of the Underlying Asset by the originator under the SPT Agreement or other alternative arrangements to

<sup>23</sup> The draft Cabinet Order has not yet been disclosed to the public as of 11 July 2011 but is expected to allow periodic distribution determined by reference to market rate of interest such as Libor.

be prescribed in the Cabinet Order (which would likely be an arrangement where the Underlying Assets are recognized in the balance sheet of the originator, regardless of the transfer of its ownership to the trustee pursuant to the SPT Agreement).

### 3. Recognition of Sukuk Established or Issued under Foreign Law

It has not been explicitly reported that the Sukuks issued under overseas jurisdiction have been offered in Japan. Some factors that are attributable to the above include uncertainty of tax treatment, a lack of market demand within Japan which has little Muslim population, and challenges over regulatory definitions of overseas Islamic products.

## D. Type of Instruments Available, Segments, and Tenure

The (Special) Bond-Type Beneficial Interests (which is anticipated to be recognised as “Sukuk” by Islamic investors) introduced in the recently amended *Asset Securitization Act* aim typically at the issuance of the Sukuk al Ijarah within the context of Japanese legislation.

## E. Tax-Related Issues

There are four key measures in the amendment of the relevant tax legislation to address taxation issues that would otherwise put the (Special) Bond-Type Beneficial Interests at a disadvantage in view of conventional bond issues:

### 1. Exclusion from Taxation on the Distribution of Profits

The distributions of profit on the book-entry (Special) Bond-Type Beneficial Interests payable to:

- a. Foreign corporations and non-residents (who do not have permanent establishment in Japan) shall be excluded from taxation, and
- b. Domestic banks and other Japanese financial institutions shall be exempted from withholding tax.

### 2. Tax Transparency of the Special Purpose Trust

The conditions for deductibility of dividends paid by the SPT have been amended to the effect that the (Special) Bond-Type Beneficial Interests have been exempted from the requirement that more than 50% of the issue amount must be offered domestically.

### 3. Exclusion of Asset Transfer-Related Tax

The purchase (buy back) transaction of the Underlying Asset from SPT to the originator (or the settler of the SPT) shall be excluded from:

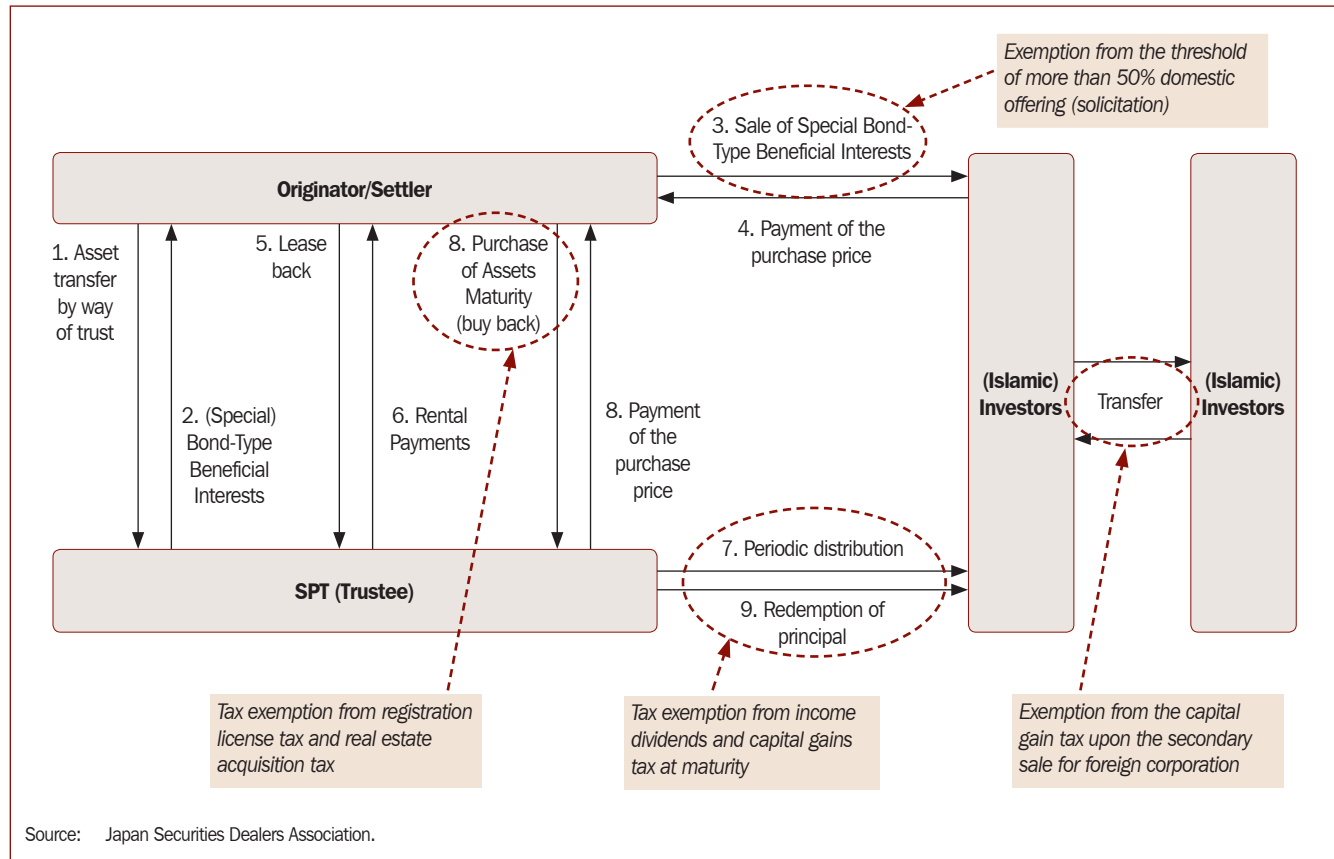
- a. Registration license tax; and
- b. Real estate acquisition tax (in respect of the SPT involving real estate as an underlying trust asset) in relation to the (Special) Bond-Type Beneficial Interests under the SPT.



#### 4. Exemption from Capital Gain Tax

Foreign corporations shall be exempted from capital gain tax upon the secondary sale of the (Special) Bond-Type Beneficial Interests.

**Figure 9.2 New Taxation Measures**



#### F. Impediments for Structuring Sukuk

1. The newly introduced Japanese Sukuk is a (Special) Bond-Type Beneficial Interests issued by SPT under the amended *Asset Securitization Act*, which is legally unique compared with the most commonly used type of trust certificates based on the Declaration of Trust. Thus, the usability of such vehicle is not well tested in the international context.
2. As this structure presupposes the Underlying Assets which actually exist and produce a stream of fixed cash-flows, it would be difficult to be used for the development-type real-estate leasing project where the Underlying Assets do not physically exist yet.
3. Relevant infrastructures such as settlement system, listing, implementation rules, accounting treatment, etc. should be developed concomitantly for facilitating the issuance of Japanese Sukuk.

In this regard, the TOKYO PRO-BOND Market, which was established by TOKYO AIM, a joint venture between the Tokyo Stock Exchange and the London Stock Exchange in

May 2011, decided to include the (Special) Bond-Type Beneficial Interests among its eligible bonds for listing and trading.

### **G. Significance of the Islamic Finance and Islamic Bonds (Sukuk) Market**

Only one Shari'ah-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, other types of Islamic financial transactions have not yet been achieved within Japan, including Islamic banking and Sukuk Issuance.

As mentioned above, several Japanese entities have issued Sukuks in overseas markets.

# X. Next Step: Future Direction

## A. Future Direction

### 1. Improvement of the Transparency of Bond Price Information

- a. Japan Securities Dealers Association (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.
- 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 it is necessary to review and improve the system.
- c. It is necessary to improve the transparency of corporate bond price information and build credibility for the information.

### 2. Enhancement of the Repo Market and Its Infrastructure

To vitalize the corporate bond secondary market, it is necessary to develop and enhance infrastructures such as a corporate bond repo market and a settlement/clearance system. Such efforts are believed to contribute to the expansion of the primary market.

Although the corporate bond repo market is expected to work as a financing and fund management tool for market participants and as means of avoiding fails, the need for repo transactions is not so large given the current corporate bond issuance size.

JSDA and market participants are engaged in discussions on how to enhance the securities settlement service functions in advance based on the corporate bond repo market and the lending functions in the U.S. and Europe in order to cope with the growth in issuance size and the expanding needs of corporate bond repo transactions in the future.

### 3. Enhancement of Functions of Settlement and Clearing Systems

A clearing house is indispensable to mitigate settlement risk, to improve the usability of investors and market participants, and to ensure liquidity. However, at the moment, as the issuance size and the transaction of corporate bonds are limited and, thus, the

netting effect of corporate bonds is not very large, JSDA and market participants have not yet established a settlement agency like the one for government bonds. 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.

## B. Group of Thirty Compliance<sup>24</sup>

The so-called G-30 Recommendations were originally conceived as the Group of Thirty's Standards on Securities Settlement Systems in 1989, detailing in a first of its kind report nine recommendations for efficient and effective securities markets and covering legal, structural and settlement process areas. The recommendations were subsequently reviewed and updated in 2001, under leadership of the Bank for International Settlements (BIS), and through the efforts of a Joint Task Force of the Committee On Payment and Settlement Systems (CPSS) and the Technical Committee of the International Organisation of Securities Commissions (IOSCO). Compliance with the G30 Recommendations in individual markets is often an integral part in securities industry participants' and intermediaries' due diligence process.

**Table 10.1 Group of Thirty Compliance**

Recommendation	Implemented
1 Eliminate paper and automate communication, data capture, and enrichment	Yes
2 Harmonize messaging standards and communication protocols	Yes
3 Develop and implement reference data standards	Yes
4 Synchronize timing between different clearing and settlement systems and associated payment and foreign exchange systems	Yes
5 Automate and standardize institutional trade matching	(Yes)
6 Expand the use of central counterparties	(Yes)
7 Permit securities lending and borrowing to expedite settlement	Yes
8 Automate and standardize asset servicing processes, including corporate actions, tax relief arrangements, and restrictions on foreign ownership	Yes
9 Ensure the financial integrity of providers of clearing and settlement services	Yes
10 Reinforce the risk management practices of users of clearing and settlement service providers	Yes
11 Ensure final, Simultaneous transfer and availability of assets	Yes
12 Ensure effective business continuity and disaster recovery planning	Yes
13 Address the possibility of failure of a systematically important institution	Yes
14 Strengthen assessment of the enforceability of contracts	Yes
15 Advance legal certainty over rights to securities, cash, or collateral	Yes
16 Recognize and support improved valuation methodologies and closeout netting arrangements	Yes
17 Ensure appointment of appropriately experienced and senior board members (of the boards of securities clearing and settlement infrastructure providers)	Yes
18 Promote fair access to securities clearing and settlement networks	Yes
19 Ensure equitable and effective attention to stakeholder interests	Yes
20 Encourage consistent regulation and oversight of securities clearing and settlement service providers	Yes

Source: Group of 30.

<sup>24</sup> Group of 30 (G30). 2003. *Global Clearing and Settlement – A Plan of Action*. <http://www.partad.ru/wrld/word/g30app1.pdf>; <http://www.group30.org/images/PDF/Global%20Clearing%20and%20Settlement%20Final%20Monitoring%20Report%202006.pdf>

### C. Group of Experts Final Report: Summary of Market Barriers Assessment – Japan (April 2010)

The GoE Report refers to the published results in 2010 of the Group of Experts (GoE) formed under Task Force 4 of the Asian Bond Market Initiative (ABMI). In the report, published under the leadership of the Asian Development Bank (ADB), a group of securities market experts from the private and public sector in ASEAN+3, as well as International Experts, assessed the ASEAN+3 securities markets on potential market barriers, the costs for cross-border bond transactions, and the feasibility for the establishment of a Regional Settlement Intermediary (RSI). The findings in the GoE Report lead to the creation of ABMF.

**Table 10.2 Summary of Market Barriers Assessment**

Potential Barrier Area	Current Situation	Market Assessment Questionnaire Scores	Overall Barrier Assessment
Quotas	There are no market entrance requirements for foreign investors.	OK	OK
Investor registration	There are no registration requirements for foreign investors.	OK	OK
FX controls - conversion	The Japanese yen is freely convertible. There are no foreign exchange restrictions. Both third-party foreign exchange (FX) and offshore FX transactions are possible.	OK	OK
FX controls - repatriation of funds	As above. Sale proceeds or income from investments can be freely repatriated.	OK	OK
Cash controls - credit balances	Foreign investors can freely open cash accounts in Japanese yen. Credit balances are allowed.	OK	OK
Cash controls - overdrafts	There are no restrictions on overdrafts for non-residents.	OK	OK
Taxes	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, International Central Securities Depositories (ICSDs) do not currently provide a service for these bonds. The calculation of tax requires historical information in some exceptional cases.	LOW	LOW
Omnibus accounts	Omnibus accounts are permitted.	OK	OK
Settlement cycle	The settlement cycle is T+3.	OK	OK
Message formats	Japan Securities Depository Center, Inc. (JASDEC) (the central securities depository [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.	OK	OK
Securities numbering	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.	OK	OK
Matching	There are trade matching and pre-settlement matching systems for bonds.	OK	OK
Dematerialisation	Most corporate bonds and municipal bonds are held in Japan Securities Depository Centre (JASDEC) in dematerialized form. Some physical certificates still exist.	LOW	LOW
Regulatory framework	The regulatory regime is regarded as stable and consistent and no adverse comments were received in this area.	-	OK

BOJ-Net = Bank of Japan-Financial Network System; ISIN = International Securities Identification Number; SWIFT = Society for Worldwide Interbank Financial Telecommunication

Source: Asian Development Bank. [https://wpqr1.adb.org/LotusQuickr/asean3goe/Main.nsf/h\\_58E34A1388F9070B48257729000C0A4E90F408746827C16248257729000C1334/\\$file/Part3.pdf](https://wpqr1.adb.org/LotusQuickr/asean3goe/Main.nsf/h_58E34A1388F9070B48257729000C0A4E90F408746827C16248257729000C1334/$file/Part3.pdf)

# XI. Examples of the Recommended Expression (RE) of 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*
- b. (RE) *Companies Act* (Japanese law translation by Ministry of Justice) = 会社法 (*kaishahou*) (AE) *Company Law*, (AE) *Corporations Act*, (AE) *Corporations Law*
- c. (RE) *Financial Instruments and Exchange Act* (Abbreviation: FIEA) (Japanese law translation by Ministry of Justice) = 金融商品取引法 (*kinyuu shouhin torihikihou*) (AE) *Financial Instruments and Exchange Act* (Abbreviation: FIEA)
- 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*)<sup>25</sup>
- f. (RE) *Cabinet Office Ordinance on Definitions under Art. 2 of the Financial Instruments and Exchange Act* = 定義府令 (*teigi furei*)<sup>26</sup>
- 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*)

<sup>25</sup> From the Name of Laws and Regulations, Financial Services Agency (FSA) Japan [http://www.fsa.go.jp/frtc/kenkyu/event/20070424\\_01.pdf](http://www.fsa.go.jp/frtc/kenkyu/event/20070424_01.pdf)

<sup>26</sup> From the Name of Laws and Regulations, Financial Services Agency (FSA) Japan [http://www.fsa.go.jp/frtc/kenkyu/event/20070424\\_01.pdf](http://www.fsa.go.jp/frtc/kenkyu/event/20070424_01.pdf)

- h. (RE) *Cabinet Office Ordinance on Financial Instruments Business, etc.* = 業府令 (*gyoufurei*)<sup>27</sup>
- 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*)
- d. (RE) Annual securities report = 有価証券報告書 (*yuukashouken houkokusho*)  
(AE) securities report
- e. (RE) Semiannual securities report = 半期報告書 (*hanki houkokusho*) (AE) semiannual report
- f. (RE) Quarterly securities report = 四半期報告書 (*shihanki houkokusho*) (AE) quarterly report
- g. (RE) Extraordinary report = 臨時報告書 (*rinji houkokusho*) (AE) current report
- h. (RE) Shelf registration statement = 発行登録書 (*hakkoutourokusho*)
- i. (RE) Supplement to shelf registration statement (Practical term) = 発行登録追補書類 (*hakkoutouroku tsuihoshorui*)<sup>28</sup>
- j. (RE) securities notice = 有価証券通知書 (*yuukashouken tsuuchisho*)

## 3. Offering and Distribution

- a. (RE) public offering (Abbreviation: PO) = 募集 (*boshuu*)  
(Japanese law translation by Ministry of Justice and 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 (*shinpatsusai koubo*)

<sup>27</sup> Government of Japan. Financial Services Agency. <http://www.fsa.go.jp/en/news/2010/20100331-4/05.pdf>

<sup>28</sup> Footnote 34. <http://www.fsa.go.jp/en/news/2010/20100331-4/03.pdf>

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 and 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 touseika*)

This is the most frequently used expression in the practice of business in Japan. This expression is used in the FSA's public relations (PR) materials.<sup>29</sup>  
Alternative expression (AE) 1 = specific investor  
This word was used in relatively old PR materials in the FSA.<sup>30</sup>

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

- e. (RE) Private placement for specified investors = 特定投資家私募 (*tokutei touseika shibo*)

This word is legally correct because this is part of private placement in Japanese Law (FIEA).

- f. (RE) Offer to specified investors (Abbreviation: Offer to SI) = 特定投資家公募 (*tokutei touseika koubo*)

This word is a practical translation focusing on the reality that many investors can be subject to public offering.

- g. (RE) Offer of newly-issued securities to specified investors = 特定投資家(新発)公募 (*tokutei touseika shinpatsu koubo*)

If the primary market offering of the new issue is distinguished from the private placement of already-issued securities, the above expression will be used.

(AE) Primary offering to specified investors

- h. (RE) Offer to specified investors = 特定投資家私売出し (*tokutei touseika shiuridashi*)

(AE) Private placement for specified investors

<sup>29</sup> (AE) shelf registration supplement, Japanese law translation by the Ministry of Justice and FSA's Official translation.

<sup>30</sup> Footnote 35. <http://www.fsa.go.jp/en/newsletter/2009/01b.html>; <http://www.fsa.go.jp/sesc/english/aboutsesc/all.pdf>



- i. (RE) Offer of already-issued securities to specified investors = 特定投資家(既発)公募 (*tokutei tousika 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 an 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 while the expression "(AE) securities intended for specified investors" is used in the FSA's PR materials.<sup>31</sup>

- 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 (*kin-yuushouhin torihiki gyousha*)

<sup>31</sup> Footnote 34. <http://www.fsa.go.jp/en/newsletter/2009/01b.html>; <http://www.fsa.go.jp/sesc/english/aboutsesc/all.pdf>

- c. (RE) registered financial institution = 登録金融機関 (*touroku kin-yuukikan*)
- d. (RE) financial instruments business operator, etc = 金融商品取引業者等 (*kin-yuushouhin 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)

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Contact (ADB Consultant):

Prof. Shigehito Inukai  
Faculty of Law, Waseda University  
1-6-1, Nishiwaseda, Shinjuku-ku, Tokyo, 〒169-8050  
Tel & Fax (Direct): + 81-(0)3-3202-2472  
Mobile: +81-(0)80-3360-7551  
E-Mail: shige.inukai@me.com