

Points to Note for Short Selling Position Reporting, etc. after Lifting Ban on Margin Trading on PTSs

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Tokyo Stock Exchange, Inc.

"Comprehensive Guidelines for Supervision of Financial Instruments Business Operators, etc." established by the Financial Services Agency (hereafter "FSA") were amended on March 18, 2019 and enforced on April 1¹. Due to this amendment, the ban on margin trading on Proprietary Trading Systems (hereafter "PTS(s)") was lifted.

In addition, on June 5, 2019, the Cabinet Office Order to Partially Amend the Cabinet Office Order on Financial Instruments Business, etc. (hereafter "Amendment Order") was promulgated and enforced². Due to this, measures such as exempting margin trading on PTSs from the short selling regulation (confirmation on securement of settlement measures and price restrictions in relation to naked short selling) were implemented. Accordingly, when conducting short selling position reporting, etc. after the enforcement of the Amendment Order, please give due consideration to the following matters.

Note that the descriptions have been condensed to facilitate understanding. For more details, please also refer to the Amendment Order, etc.

1. Points to Note for the Amendments

With the enforcement of the Amendment Order, Article 9-3, Paragraph 3, Item 5 of the "Cabinet Office Order on Restrictions on Securities Transactions" (hereafter "Transaction Restriction Order") was added. This provision exempts margin trading on PTSs from the requirement to confirm whether settlement measures are secured in relation to naked short selling.

Article 15, Paragraph 3, Item 2 of the Transaction Restriction Order was also added. With this, where an individual investor³ conducts margin trading of no more than 50 trading units on a PTS, the price restrictions on short selling are exempted. However, note that the trading units referred herein mean those specified by the PTS, not by Tokyo Stock Exchange (hereafter "TSE")

Therefore, please be aware of the points indicated in 2 and 3 below.

¹ For the outline of the amendment to Comprehensive Guidelines for Supervision of Financial Instruments Business Operators, etc., see the website of the Financial Services Agency ("FSA"). (<https://www.fsa.go.jp/en/newsletter/weekly2019/337.html>)

² For the outline of the Cabinet Office Order to Partially Amend the Cabinet Office Order on Financial Instruments Business, etc., see the FSA website (<https://www.fsa.go.jp/en/newsletter/weekly2019/347.html>)

³ More precisely, as stipulated in Article 15, Paragraph 3, Item 2 of the Transaction Restriction Order, it is defined as a person that does not fall under the Qualified Institutional Investor prescribed in Article 2, Paragraph 2, Item 1 of the Financial Instruments and Exchange Act (including foreign corporations equivalent thereto). However, for the sake of simplicity, such person is hereafter referred to as an individual investor.

2. Points to Note for Short Selling Price Restrictions

As mentioned above, the trading units referred to in the added Article 15, Paragraph 3, Item 2 of the Transaction Restriction Order are those specified by PTSs. As such, if the same stock is traded on TSE and a PTS in different trading units, the short selling price restrictions may be applied in different ways, depending on the amount of transactions⁴.

For example, in the case where the trading unit of an ETF at TSE is one unit while that of the same ETF at a PTS is 10 units, if an individual investor places an order to sell 100 units on margin, the amount of said order exceeds 50 times the trading unit (one unit) at TSE, thereby, NOT falling under Article 15, Paragraph 1, Item 2 of the Transaction Restriction Order. However, the same order falls within 50 times the trading unit at the PTS, thereby being exempted from the short selling price restrictions in accordance with the added Article 15, Paragraph 3, Item 2 of the same Order.

In this way, for an issue(s) whose trading unit at TSE is different from that at a PTS(s)⁵, there may arise a difference between TSE and the PTS in the application of the short selling price restrictions. Thus, securities firms are advised to adequately verify such orders before their placement.

3. Points to Note for Short Selling Position Reporting

Article 15-2, Paragraphs 1 and 2 stipulate that exchange trading participant securities firms, etc. are required to provide information on short selling positions to TSE (a principal financial instruments exchange) for proprietary and customer accounts

The initial criteria⁶ that require short selling position reporting are the short selling position ratio of 0.2% and short selling positions of over 50 trading units (Article 15-2, Paragraph 1, Item 1 and Paragraph 6, Item 1).

- **How to Calculate Short Selling Position Ratio**

Article 15-3, Paragraph 1, Item 7 of the Transaction Restriction Order stipulates that the short selling position ratio, one of the criteria requiring short selling positions, shall be the numerical value obtained by dividing (a) the amount of short selling positions by (b) the total number of issued shares (or issued units). Moreover, the amended Article 15-3, Paragraph 2 of the same Order stipulates that the numerator (a) (the amount of short selling positions) shall be calculated, upon excluding margin trading of no more than 50

⁴ Although we focus on the contrast between TSE and PTSs, if the trading unit for a certain issue differs from one PTS to another, there may arise differences in the applicability of short selling price restrictions among PTSs.

⁵ TSE and PTSs are independently setting the trading unit of each issue. TSE has consolidated trading units of all domestic stocks into 100 shares as of October 1, 2018 while trading units of ETFs, etc. differ depending on each issue. For trading units of each issue at PTSs, please contact each PTS.

⁶ In addition to the initial reporting, if there has been a 0.1% or more change in the short selling position ratio and the number of trading units in short selling positions is over 50, amendment reporting is required (Article 15-2, Paragraph 1, Item 2 and Paragraph 6, Item 2 of the Transaction Restriction Order). If the short selling position ratio has fallen below 0.2% or the number of trading units in short selling positions has fallen to 50 or less, the final reporting is required (Paragraph 1, Item 3 or Paragraph 6, Item 3 of the same article).

trading units by each individual investor.

As mentioned in 1. above, there are cases where the trading unit of an issue at TSE is different from that of the same issue at a PTS. If an individual investor has conducted margin trading of such issue on TSE and the PTS, then the short selling position ratio shall be calculated by dividing (a) the amount that combines (i) the amount of short selling positions calculated for TSE and (ii) that calculated for the PTS by (b) the total number of issued shares (or issued units).

- **How to Calculate Number of Trading Units in Short Selling Positions**

Article 15-2, Paragraph 7 of the Transaction Restriction Order stipulates that the number of trading units, another criterion requiring short selling position reporting, shall be the numerical value obtained by dividing (a) the amount of short selling positions by (b) the trading unit. Since this provision has not been amended, note that the trading unit at TSE⁷ shall be used as the trading unit (denominator) for such calculation

In other words, when calculating the number of trading units in short selling positions, the numerator (i.e., the amount of short selling positions) is calculated, taking into account the trading unit specified by PTSs, while the denominator (i.e., trading unit) will be the trading unit specified by TSE, which does NOT take into account trading units specified by PTSs

- **Practical Process of Short Selling Position Reporting**

Practical process of Short Selling Position Reporting after the enforcement of the Amendment Order is summarized below.

(1) The amount of short selling positions (*) will be calculated for TSE and PTSs separately, and both amounts will be aggregated.

*Amounts that pertain to exemption from application, such as the amount of margin trading of no more than 50 trading units by individual investors, will be deducted from the amount of short selling positions.

(2) The aggregated amount obtained in (1) above will be divided by the total number of issued shares (or issued units) to calculate the short selling position ratio.

(3) The aggregated amount obtained in (1) above will be divided by the trading unit specified by TSE to calculate the number of trading units in short selling positions.

(4) If the short selling position ratio calculated in (2) above is 0.2% or more and the number of trading units in short selling positions calculated in (3) above is over 50, then short selling position reporting to TSE will be mandatory⁸.

⁷ This applies in cases where TSE is the principal financial instruments exchange; hereafter the same.

⁸ In the case of the initial reporting. Also refer to footnote 6.

(5) The short selling position reporting to TSE in (4) above includes the following items.

- Trade name or name of the short seller (Article 15-3, Paragraph 1, Item 1 of the Transaction Restriction Order)
- Address or location of the short seller (Item 2 of the same paragraph)
- Information on trust assets or assets under management (Item 3 of the same paragraph)
- Name of the issue that was sold short
- Date of calculating the short selling position ratio (Item 5 of the same paragraph)
- The amount of short selling positions (calculated in (1) above; Item 6 of the same paragraph)
- The number of trading units in short selling positions (calculated in (3) above; Item 6 of the same paragraph)
- The most recent short selling position ratio (Item 8 of the same paragraph)⁹

The above process is just an example. Please adjust the process as needed in line with your company's operational practices while complying with the laws and regulations.

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⁹ The most recent short selling position ratio is required to be included in amendment reporting and final reporting