

Clearing Framework Concerning Creation/Redemption of ETF

April 24, 2019

Japan Securities Clearing Corporation

I. Purpose

Aiming to activate ETF market by improving serviceability of Creation/Redemption of ETF, JSCC launched the” Working Group to Discuss Clearing Framework, Etc. Related to Creation/Redemption of ETF“, and has discussed the outlines of clearing framework across industry since July 2018. In light of the discussion in the working group, JSCC will amend the framework as necessary to include obligations to deliver listed securities (meaning listed securities on the Financial Instruments Exchange that are JSCC’s trades eligible for Clearing; the same applies hereinafter) and obligations to pay cash, related to Creation/Redemption of ETF in JSCC’s trades eligible for Clearing and introduce the framework (hereinafter referred to as the “Framework”) for clearing related to Creation/Redemption of ETF.

II. Outlines

Item	Outlines	Remarks
1. Trades Eligible for Clearing	• Trades eligible for Clearing by JSCC include the delivery/receipt of ETF, and listed securities and payment/receipt of cash, related to creation (including an additional creation; the same applies hereinafter) and redemption (including a partial redemption by cash; the same applies hereinafter), related to either of the following (i) to (iii) among ETF listed on the Financial Instruments Exchange (limited to those fall in investment trust beneficiary securities and of which trustee or re-trustee is a Registered ETF Trust Bank (refer to below 2.(3))	• Contracts Subject to Clearing include the delivery/receipt of ETF and listed securities and payment/receipt of cash, related to creation for which application is made on and after two (2) Business Days prior to the ETF listing day and settled on and after the ETF listing day.

Item	Outlines	Remarks
	<ul style="list-style-type: none"> (i) In-kind Creation/ In-kind redemption type ETF set forth in Article 12, Item 2 of Enforcement Order for Act on Investment Trusts and Investment Corporations (hereinafter referred to as the “Enforcement Order”). (ii) Cash creation/In-kind redemption type ETF (as stipulated in Article 12, Item 1 of the Enforcement Order) (iii) Cash creation/Cash redemption type ETF (as stipulated in Article 8 of the Act on Investment Trusts and Investment Corporations.) 	<ul style="list-style-type: none"> • In-kind creation/In-kind redemption type ETF (described in left column (i)) and Cash creation/In-kind redemption type ETF (described in (ii) of left column) are limited to those for which all component stock issues are eligible for Securities Clearing.
<p>2. Clearing Participant Framework</p> <p>(1) Existing Clearing Participant owing a Securities Clearing Qualification (hereinafter referred to as the “Securities Clearing Participant”)</p> <p>(2) ETF Special Clearing Participant</p>	<ul style="list-style-type: none"> • A Securities Clearing Participant may apply for Clearing related to Creation/Redemption of ETF (meaning those related to trades eligible for Clearing described in 1. above; the same applies hereinafter.) • A new clearing qualification with which a management company (meaning an asset management company, which is a settlor of the investment trust related to ETF; the same applies hereinafter) applies for Clearing related to Creation/Redemption of ETF (hereinafter referred to as “ETF Special Clearing Qualification”) is set and the management company obtaining such Qualification is set to be as a Clearing Participant related to Creation/Redemption of ETF (hereinafter referred to as “ETF Special Clearing Participant”) . 	<ul style="list-style-type: none"> • For ETF Special Clearing Qualification, Agency Clearing Qualification is not set.

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(3) Registered ETF Trust Bank	<ul style="list-style-type: none"> • A management company may submit an application to JSCC to obtain ETF Special Clearing Qualification and obtain such Qualification, upon an approval by JSCC. Establishing sound management structure and appropriate business execution structure are required for acquisition criteria and maintenance criteria for ETF Special Clearing Qualification. • JSCC registers a trust bank, which is a principal body to conduct settlement operations related to Creation/Redemption of ETF, as the “Registered ETF Trust Bank”, based on its application. JSCC may require a Registered ETF Trust Bank to submit a report, to the extent necessary for JSCC’s clearing business. 	<ul style="list-style-type: none"> • An ETF Special Clearing Participant is required to submit a prescribed filing and/or reports and subject to suspension of Clearing or cancellation of qualification due to a breach of the Business Rules. • Relationship between ETF Special Clearing Participant and Registered ETF Trust Bank is described in below 7.(2). • Registered ETF Trust Bank is required to submit prescribed filing and/or reports and is subject to suspension of registrations and other measures.
3. Brokerage for Clearing of Securities, etc.	<ul style="list-style-type: none"> • Securities Clearing Participant owing an Agency Clearing Qualification may conduct Brokerage for Clearing of Securities, etc. related to Creation/Redemption of ETF, upon commission by an Authorized Participant (meaning a party designated by a management company related to the relevant ETF as a party to handle the offering of ETF; the same applies hereinafter). 	<ul style="list-style-type: none"> • Brokerage for Clearing of Securities, etc. related to Creation/Redemption of ETF is commissioned to the party whom the Brokerage for Clearing of Securities, etc. of Cash Securities is commissioned. • A management company is not allowed to commission Brokerage

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		for Clearing related to Creation/Redemption of ETF to a Securities Clearing Participant owning an Agency Clearing Qualification.
4. Clearing	<ul style="list-style-type: none"> • An application for Clearing related to Creation/Redemption of ETF is made by notifying JSCC of necessary information via the platform system. • Upon confirmation of obligations to be cleared by JSCC with above notification, JSCC clears obligations between a Securities Clearing Participant and an ETF Special Clearing Participant based on the contents of such notification. 	<ul style="list-style-type: none"> • The platform system means the system provided by JSCC for Creation/Redemption of ETF, as an interface for Authorized Participants, management companies and trust banks to exchange information and submit an application for Creation/Redemption of ETF.
5. Initial Margin (1) Handling of the portion related to Securities Clearing Qualification (2) Handling of the portion related to ETF Special Clearing Qualification	<ul style="list-style-type: none"> • Required Initial Margin Amount related to Securities Clearing Qualification is calculated, taking into account of unsettled portion related to Creation/Redemption of ETF. • Deposit of Initial Margin related to ETF Special Clearing Qualification by a Special Clearing Participant is not required. 	

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<p>6. Clearing Fund</p> <p>(1) Handling of the portion related to Securities Clearing Qualification</p> <p>(2) Handling of the portion related to ETF Special Clearing Qualification</p>	<ul style="list-style-type: none"> • Required Clearing Fund Amount related to Securities Clearing Qualification is calculated, taking into account of the unsettled portion related to Creation/Redemption of ETF. • Deposit of Clearing Fund related to ETF Special Clearing Qualification by a Special Clearing Participant is not required. 	
<p>7. Settlement of Listed Securities and Cash</p> <p>(1) Handling of the portion related to Securities Clearing Participant</p>	<ul style="list-style-type: none"> • Delivery/receipt of listed securities and payment/receipt of cash between JSCC and Securities Clearing Participant are subject to netting in DVP settlement. 	<ul style="list-style-type: none"> • Provided, however, that at time of ETF settlement between a Securities Clearing Participant and JSCC in case of redemption, ETF Shares including Residual Number of ETF Shares to be Returned are settled via DVP settlement and JSCC will return Residual Number of ETF Shares to be Returned to the relevant Securities Clearing Participant.

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<p>(2) Handling of the portion related to ETF Special Clearing Participant</p> <p>(3) Priority Order of Delivery of Securities to Receiving Participants</p>	<ul style="list-style-type: none"> • Delivery/receipt of listed securities and payment/receipt of cash between JSCC and an ETF Special Clearing Participant are made between JSCC’s account and the account with Registered ETF Trust Bank, which an ETF Special Clearing Participant designates for each ETF issue. • Delivery/receipt of listed securities and payment/receipt of cash between JSCC and ETF Special Clearing Participant are made without netting between portion related to creation and that related to redemption. • When a delivering participant has failed to deliver securities by the settlement cutoff time due to unavoidable circumstances (hereinafter referred to as “Fail”), in handling priority in securities receipt among receiving participants who are participants other than the Fail-affected Participant, ETF Special Clearing Participants will be prioritized to Securities Clearing Participants. 	<ul style="list-style-type: none"> • Priority in securities receipt among receiving participants is described in the annex attached hereto. • Procedures for ETF Special Clearing Participant and Securities Clearing Participant to handle rights in case of occurrence of Fail on the record date will be prescribed in “Guidance for Clearing Participants upon Occurrence of Delivery Failure on a Record Date”.

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8. Scheme for Settlement Default	<p>If JSCC acknowledges that an ETF Special Clearing Participant may not be able to conduct Creation/Redemption of ETF, JSCC may suspend Clearing related to the relevant ETF Special Clearing Participant.</p> <ul style="list-style-type: none"> • For Creation/Redemption of ETF, if JSCC acknowledges that ETF Special Clearing Participant may not be able to conduct Creation/Redemption of ETF, unperformed obligations related to Creation/Redemption of ETF shall become invalid retroactively upon the time of application for Clearing and JSCC will return listed securities and/or cash received from the Securities Clearing Participant. 	
9. Loss Compensation Scheme	<ul style="list-style-type: none"> • Losses resulting from default of Securities Clearing Participant related to Trades eligible for Clearing under the Framework will be subject to current loss compensation scheme. 	<ul style="list-style-type: none"> • Handling of cases where an ETF Special Clearing Participant is not able to conduct creation and/or redemption of ETF is described in above 8.
10. Timing of Enforcement	<ul style="list-style-type: none"> • Targeted at around January, 2021. 	

End of Document

Priority in Securities Receipt among Receiving Participants After Implementation of the Framework

