

Outline of Structure relating to Single Name CDS Clearing

October 22, 2014

Japan Securities Clearing Corporation

I. Purpose

Since the start of its credit default swap clearing business in July 2011, JSCC has offered clearing for Index CDS contracts, each of which is linked to more than one reference entity. To expand the eligible trade scope, JSCC intends to add Single Name CDS contracts, each of which is linked to only one reference entity, and make necessary changes to the existing structure.

II. Overview

Item	Descriptions	Remarks
<p>1. Transactions eligible for clearing</p> <p>(1) Requirements for eligible issues</p>	<ul style="list-style-type: none"> • Single Name CDS eligible for clearing shall meet the following requirements: <ul style="list-style-type: none"> ✓ Complying with Standard Japan Corporate of Credit Derivatives Physical Settlement Matrix; ✓ Having a tenor of 5 years and 3 months or less from the Effective Date to the Scheduled Termination Date. ✓ Having any of key fixed coupons traded in the market. 	<ul style="list-style-type: none"> • Initially, some 10 issues which are considered highly liquid will be selected from the on-the-run index components of iTraxx Japan Index CDS. • After the launch of Single Name CDS clearing, issues eligible for clearing will be added in stages in view of the situation of the operation of the clearing business. • Expansion of tenors will be discussed in view of the situation of the operation of the clearing business after its launch, as needed. • The fixed coupons will be designated from 25bps, 100bps or 500 bps, which are unified fixed coupons. • If there is any change to the key fixed coupons traded in the market, issues with new fixed coupons shall be added as eligible for clearing.

Item	Descriptions	Remarks
<p>(2) Treatment of issues closely linked to Participants</p> <p>(3) Exclusion of eligible issues</p>	<ul style="list-style-type: none"> • To avoid wrong-way risks, a Clearing Participant shall not hold short positions of a Reference Entity in an issue of its own or a company part of the same corporate group. • If the Reference Entity in a cleared Single Name CDS issue of a Clearing Participant is incorporated into the same corporate group due to business reorganization, the Clearing Participant shall close out the short positions in the issue within a certain period of time after the Effective Date of the business reorganization. • To cover wrong-way risks, the notional amount of the relevant issue shall be added to the required amount of Initial Margin for the Clearing Participant after the Effective Date of the business reorganization. • Of the eligible issues with the clearing balance at JSCC standing at zero, issues that are deemed unnecessary for continued clearing services due to a significantly low level of liquidity in the market may be excluded. 	<ul style="list-style-type: none"> • If short positions cannot be closed out within the period of time mentioned on the left, the positions shall be put up for an auction and forcibly closed out. Any losses arising from the auction shall be covered by the Clearing Participant. • The Clearing Participant may assume obligations only for an offsetting position with the same tenor to terminate positions of the relevant issue. • If the Reference Entity in the issue is subject to Short Charge at the same time (or has the largest amount of net sales among other positions held by the Clearing Participant), Short Charge shall not be added.
<p>2. Clearing Curve</p> <p>(1) Issues and grid points subject to quotes submission</p>	<ul style="list-style-type: none"> • Clearing Participants shall submit quotes daily for an issue in which they hold Single Name CDS positions cleared by JSCC. • Any Clearing Participant designated by JSCC based on application by a Clearing Participant shall submit quotes for all the Single Name CDS issues eligible for clearing at JSCC, regardless of whether they hold positions in such issues. • Grid points subject to quotes submission shall be 1-year, 3-year and 	<ul style="list-style-type: none"> • The Clearing Participant designated by JSCC based on application from a Clearing Participant can receive discount rates for the clearing fee (see remarks in 6. (1)). • JSCC shall designate such Clearing Participant based on a separate application from the designation relating to Index

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(2) Notional amount referred to in submitting quotes	5-year. <ul style="list-style-type: none"> A Clearing Participant shall submit quotes for a Single Name CDS contract with a notional amount of JPY500 million. 	CDS.
(3) Time and method for quotes submission	<ul style="list-style-type: none"> A Clearing Participant shall submit quotes that it believes can be traded for 45 minutes between 15:15 and 16:00 through Markit's service, as with Index CDS. 	<ul style="list-style-type: none"> The hours for submitting quotes for Index CDS will be changed to the period of time mentioned on the left (for 15 minutes from 15:15 to 15:30).
(4) Constraint grids for quotes	<ul style="list-style-type: none"> constraint grids for quotes shall be set for individual grid points of each issue, as with Index CDS, to be used for adjustments of quotes submitted by Clearing Participants, as with Index CDS. 	<ul style="list-style-type: none"> Markit shall determine the constraint grids of the 5-year grid point based on the market condition of the day. Constraint grids multiplied by a rate predetermined by JSCC shall be the constraint grids for other grid points. The rate for individual grid points for each issue shall be reviewed periodically. The constraint grids for quotes may be changed if deemed necessary by JSCC, such as in a sudden change in stock prices.
(5) Process for constructing Clearing Curve	<ul style="list-style-type: none"> Clearing curves shall be constructed based on the price for a grid point of each issue determined based on submitted quotes. 	<ul style="list-style-type: none"> The price for each grid point shall be determined in the same manner as for Index CDS.
(6) Mechanism to ensure reliability of price for each grid point	<ul style="list-style-type: none"> The following approaches shall be taken to ensure the reliability of prices for each grid point. <ul style="list-style-type: none"> ① In case submitted quotes are deviated from the overall level to a certain extent <ul style="list-style-type: none"> With regard to quotes submitted by a Clearing Participant, if the bid price is higher than the ask price in determining the price for 	<ul style="list-style-type: none"> The additional fee will be charged approximately once or twice a month for one to several issues each time. The specific date

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(7) Setting dry-run period	<p>each grid point, an additional fee of JPY50, 000 shall be charged at a certain frequency.</p> <p>② In case submitted quotes are found to be outliers</p> <ul style="list-style-type: none"> • If quotes submitted by a Clearing Participant are removed as outliers in determining the price for each grid point, an additional fee of JPY50,000 shall be charged on second offense, and JPY100,000 for a third time or more. <p>③ In case quotes are not submitted</p> <ul style="list-style-type: none"> • If a Clearing Participant that is obliged to submit quotes for a certain issue fails to do that, an additional fee of JPY50,000 shall be charged on second offense, and JPY100,000 for a third time or more. <p>• The first nine months after the launch of Single Name CDS clearing shall be positioned as a period for mastering the service relating to quotes submission and revising the structure thereafter, during which the above provisions from ① to ③ in (6) shall not be applied.</p>	<p>and issues subject to the additional fee will be determined by JSCC at its own discretion.</p> <ul style="list-style-type: none"> • Even if quotes for several issues or for several grid points of a single issue are classified as such, the amount of the additional fee shall be JPY50,000. • Issues for which less than eight Participants submit quotes will be exempt from the additional fee. • Same as for Index CDS • Same as for Index CDS • Revise the structure in view of the situation of operations during the dry-run period, as needed.
3. Initial Margin		

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(1) Calculation method	<ul style="list-style-type: none"> As with the current calculation method for Index CDS clearing, Initial Margin shall be determined in such a manner as to cover the average of the top 1% of daily changes in net present value, which are calculated based on changes in spreads over the past 750 days, under a certain stress scenario and with a holding period of 5 days. 	<ul style="list-style-type: none"> The amount of daily change in NPV shall be calculated for each Single Name CDS and Index CDS cleared contract before being aggregated.
(2) Short Charge	<ul style="list-style-type: none"> Short Charge shall be an amount that is 80% of the largest net sales amount for a Reference Entity after netting Single Name and Index CDS positions with the same Reference Entity. 	
(3) Bid/Offer Charge	<ul style="list-style-type: none"> As with Index CDS, Bid/Offer Charge shall be an amount that is a bid/offer spread set for each issue (a spread between bid/offer and Mid) multiplied by PV01. 	<ul style="list-style-type: none"> The spread will be set according to the prevailing market rates and updated monthly.
(4) Credit Event Margin	<ul style="list-style-type: none"> As with Index CDS, Credit Event Margin shall be an amount that is the net sales of an issue subject to a credit event, multiplied by a certain percentage. 	<ul style="list-style-type: none"> The certain percentage will be set each time considering the prevailing market rates.
(5) Concentration Charge	<ul style="list-style-type: none"> As with Index CD, the required amount of Initial Margin shall be raised for a Clearing Participant if the net notional amount of an individual issue held by the Participant reaches a certain level (application level). 	<ul style="list-style-type: none"> If the notional amounts of more than one issue (including Index CDS contract) exceeds the application level, the required amount of IM will be multiple by the highest rate of increase set for each issue. The application level will be verified at least once a year in principle, and revised as needed.

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4. Clearing Fund	<ul style="list-style-type: none"> • Clearing Fund shall be calculated using the same calculation method as the current one for Index CDS, for both Index and Single Name CDS. 	
5. Treatment of Default Management Scheme (1) Hedging of risks (2) Portfolios at auction (3) Participation in auction	<ul style="list-style-type: none"> • JSCC shall perform necessary hedge transactions based on advice from the CDS Default Management Committee, with respect to Index CDS and Single Name CDS portfolios of a defaulting Clearing Participant. • Each time a default of a Clearing Participant occurs, the CDS Default Management Committee shall discuss a combination of Index CDS and Single Name CDS portfolios to be put up at auction and the bidding process. • The auction bidding process shall be selected from the following methods for each portfolio considering the notional amount of the portfolio, etc. (For details, see (4) Auction procedures): <ul style="list-style-type: none"> ➤ One Participant Winning All Method; and ➤ Bid-by-bid Method • Non-defaulting Clearing Participants shall participate in all auctions, regardless of whether they hold positions in Index CDS or Single Name CDS. 	<ul style="list-style-type: none"> • Hedge transactions shall be executed for the entire portfolio of Index CDS and Single Name CDS. • Such Clearing Participants will be allowed not to offer a bid at part or all of the auctions for reasons deemed as unavoidable by JSCC.

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(4) Auction methods	<ul style="list-style-type: none"> • An auction using the One Participant Winning All Method shall be conducted in the following manner: <ul style="list-style-type: none"> ① One Clearing Participant may offer a bid at an auction; ② A Clearing Participant offering the best bid price shall win the entire portfolio put up for the auction; and ③ The result of auction shall be fixed upon completion of the deposition of the required amount of collateral relating to losses from an auction by non-defaulting Participants. • The Bid-by-bid Method shall be the same as the current auction procedure for Index CDS; • Bidding for multiple auctions shall be conducted during the same hours for all of them. • If the total of losses exceed financial resources in the fifth tier or above, as mentioned in (5) in the Remarks column, as a result of an auction, all the auctions shall be deemed unsuccessful and Participants and JSCC shall discuss possible measures. (If agreement cannot be reached, all the positions shall be terminated early). 	<ul style="list-style-type: none"> • The best bid price is a price that will generate a minimum amount of losses for JSCC at auction. • Collateral deposited by non-defaulting Participants will be treated in the same manner as under the existing arrangements. • This refers to a method that sets a bidding unit by equally dividing the portfolio and enables multiple Clearing Participants to win a bid. • Same as under existing arrangements
(5) Loss compensation method at auction	<ul style="list-style-type: none"> • For any losses arising from the auction, the aggregate losses from all the auctions (including losses to JSCC due to other default management procedures) and loss compensation losses (the total of the first to fifth-tier loss compensation resources) shall be pro-rated according to the percentage of losses for each auction, and loss compensation resources shall be used for the pro-rated losses in the order from first to fifth tiers. 	<ul style="list-style-type: none"> • If an auction produces profit, the amount of profit shall be deducted from the aggregate losses. • Loss compensation resources shall be used in the following order: <ul style="list-style-type: none"> 1st Tier: Margin/Clearing Fund deposited by the defaulting Clearing Participant; 2nd Tier: Compensation by JSCC;

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<p>(6) Mechanism to increase the likelihood of auction success</p>	<ul style="list-style-type: none"> • In consuming the third-tier loss compensation resource, the following approaches shall be used for each style of auction to increase the likelihood of auction success. <ul style="list-style-type: none"> ① In case of auction using One Participant Winning All Method <ul style="list-style-type: none"> • If a Clearing Participant does not offer a bid at an auction, the entire amount of Clearing Fund deposited by the Clearing Participant shall be used ahead of other Clearing Participants in consuming the third-tier loss compensation resource. • With regard to Clearing Funds deposited by Clearing Participants offering bids at an auction, the entire amount of Clearing Fund deposited by such Clearing Participant making bids shall be used in the order of bid price from lowest to highest. • The Clearing Fund deposited by a Clearing Participant offering a bid price lower than a certain range of deviation from the bid-winning price shall be used in full after the Clearing Fund deposited by a Clearing Participant not offering a bid. 	<p>3rd Tier: Clearing Fund deposited by non-defaulting Clearing Participants and compensation by JSCC;</p> <p>4th Tier: Special Clearing Charge collected from non-defaulting Clearing Participants; and</p> <p>5th Tier: Compensation by the recipient of VM, etc.</p> <ul style="list-style-type: none"> • If multiple Clearing Participants do not offer a bid, the resource shall be pro-rated for use among the Clearing Participants. • The resource mentioned on the left shall not be used for a Clearing Participant that does not participate in an auction for a reason deemed unavoidable by JSCC. • The predetermined range of deviation shall be determined each time by JSCC to cover quotes that are significantly deviated from market quotations given the composition and size of the auction portfolio as well as market conditions. JSCC

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	<p>② In case of auction using the Bid-by-Bid Method</p> <ul style="list-style-type: none"> • Same as under the existing arrangements for Index CDS clearing 	<p>shall notify such range to each Clearing Participant before auction.</p> <ul style="list-style-type: none"> • The same shall apply for the order of use for Special Clearing Charge in a compensation using the fourth-tier loss compensation resource. • If there are multiple relevant Clearing Participants, the resource shall be pro-rated for use among the Clearing Participants. • After using the entire amount of Clearing Fund deposited by a Clearing Participant that does not offer a bid or a Clearing Participant that offers a bid price lower than the predetermined range of deviation from the bid-winning price, an amount of money shall be withdrawn from the Clearing Fund deposited by a Clearing Participant that offers the lowest bid price according to the volume of bids won for that price, before using the Clearing Fund deposited by a Clearing Participant offering a price from lowest to highest.
<p>6. Fee schedule (1) Clearing fee</p>	<ul style="list-style-type: none"> • The fee rates shall be set as follows: • The clearing fee shall be JPY4,800 for a notional amount of JPY100 million per cleared Single Name CDS transaction; provided however that the monthly fee shall be no less than JPY100,000 and up to JPY40,000,000 per Clearing Participant. 	<ul style="list-style-type: none"> • A discount price of JPY4,200 for a notional amount of JPY100 million shall be applied to Clearing Participants reporting quotes for all eligible Single Name issues. • The clearing fee for trades executed before the launch of JSCC's Single Name clearing services (back loading) shall be JPY2,400 for a notional amount of JPY100 million.

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(2) Other fees	<ul style="list-style-type: none"> • Early Termination Fee JPY3,000 per Early Termination • Credit Event Settlement Processing Fee JPY3,000 for one trade eligible for Credit Event Settlement. 	
7. Effective Date	<ul style="list-style-type: none"> • The effective date shall be December 15, 2014. (Effective date requires permission from the Commissioner of the Financial Services Agency.) 	

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