

Partial Amendment of IRS Clearing Structure for DCO Registration

February 27, 2013

Japan Securities Clearing Corporation

I. General Purpose

Section 5(b) of US Commodity Exchange Act requires an acquisition of the Derivatives Clearing Organization (hereinafter referred to as “DCO”) registration from US Commodity Futures Trading Commission (hereinafter referred to as “CFTC”) when engaging in the clearing of derivatives transactions with US financial institutions, etc. In the IRS clearing business launched on October 9, 2012, it is expected that JSCC will need to acquire DCO registration in order to clear so-called Japan book vs. US book transactions.

While JSCC needs to meet CFTC regulatory requirements related to DCO upon receiving DCO registration, the following requirements are set forth in CFTC regulations, and thus JSCC will amend the structure to address such requirements:

- In the clearing member qualification requirement, DCO shall not require that the clearing members maintain swap portfolio of any particular size;
- In the clearing member qualification requirement, DCO shall not set a minimum capital requirement of more than USD50,000,000;
- The capital amount of the clearing member shall appropriately match risks;
- DCO shall impose risk limits on a clearing member by house origin and customer origin;
- DCO shall permit a clearing member to outsource the participation in auctions at the time of a default of a clearing member to a third party;
- DCO shall submit financial information pertaining to the clearing members other than FCM (futures commission merchants) to CFTC upon request; and
- With respect to the materials related to risk management of the clearing members, DCO shall adopt rules setting forth the requirement to submit such materials to CFTC upon request.

II. Outline

Item	Details	Remarks
1. Changes to IRS Clearing Qualification Requirements	<ul style="list-style-type: none"> <li data-bbox="168 587 432 667">(1) Portfolio Criteria <ul style="list-style-type: none"> <li data-bbox="454 587 1319 667">▪ Abolish the requirements of the outstanding amount of IRS Transactions being not less than JPY10 trillion. <li data-bbox="168 715 432 794">(2) Net Capital Amount Criteria <ul style="list-style-type: none"> <li data-bbox="454 715 1319 842">▪ Among IRS Clearing Qualification requirements, the requirement of the Net Capital Amount being not less than JPY100 billion will be reduced to lesser of (i)USD50 million or (ii) JPY5 billion. 	<ul style="list-style-type: none"> <li data-bbox="1341 715 2067 842">▪ If the denomination of the Net Capital Amount is neither USD nor JPY, such amount shall be converted into JPY by a method prescribed by JSCC.
2. Raising Initial Margin, etc.	<ul style="list-style-type: none"> <li data-bbox="168 1018 432 1262">(1) Risk Limits in Clearing Participant's Aggregate Positions <ul style="list-style-type: none"> <li data-bbox="454 1018 1319 1262">▪ If the total Required Initial Margin Amount of a Clearing Participant (sum of the Required Initial Margin Amount for its proprietary accounts and all of the Clearing Customers' accounts) exceeds 200% of its Net Capital Amount, after hearing, JSCC will be able to suspend a new Assumption of Obligations and give Instructions for Improvement on position holding to the Clearing Participant. 	<ul style="list-style-type: none"> <li data-bbox="1341 1018 2067 1145">▪ When deciding on taking measures, the status of the transactions other than Clearing Contracts may be taken into consideration. <li data-bbox="1341 1145 2067 1262">▪ As to the methods of improvement on position holding, reduction in positions as well as increase of the Net Capital Amount will be permitted.

Item	Details	Remarks
(2) Risk Limits in Clearing Participants' Proprietary and each Customer Account	<ul style="list-style-type: none"> ▪ If the Required Initial Margin Amount for the proprietary account of the Clearing Participant exceeds 50% of the Net Capital Amount of the relevant Clearing Participant, the Required Initial Margin Amount for the proprietary account of such Clearing Participant will be raised, and if it exceeds 100%, then after hearing, JSCC will be able to suspend a new Assumption of Obligations relating to the proprietary account of the relevant Clearing Participant, as well as give Instructions for Improvement of position status. ▪ If the Required Initial Margin Amount for any of the Clearing Customers of a Clearing Participant exceeds 50% of the Net Capital Amount of the relevant Clearing Participant, the Required Initial Margin Amount for the Clearing Customer whose Required Initial Margin Amount has exceeded 50% shall be raised, and if it exceeds 100%, then after hearing, JSCC will be able to suspend a new Assumption of Obligations with respect to the relevant Clearing Customer, as well as give Instructions for Improvement on position holding to the relevant Clearing Participant. 	<ul style="list-style-type: none"> ▪ This shall be the matter to be consulted with the Disciplinary Measures Assessment Committee. ▪ When deciding on taking measures, the status of the transactions other than Clearing Contracts may be taken into consideration. ▪ Please see Annex, for detailed criteria for and rate of increase of the Required Initial Margin Amount so raised. ▪ As to the method of Improvement on position holding, reduction in positions as well as increase of the Net Capital Amount will be permitted. ▪ The suspension of a new Assumption of Obligations and Instructions for Improvement of position status shall be the matter to be consulted with the Disciplinary Measures Assessment Committee. ▪ Before exceeding the risk limit mentioned in left column under "Details," the attention of the relevant Clearing Participant shall be drawn through inquiry, etc.
(3) Handling	<ul style="list-style-type: none"> ▪ The measures of raising Required Initial Margin Amount described in (2) above will be taken cumulatively with the measures of raising Initial Margin for other reasons, such as raising Initial Margin in 	<ul style="list-style-type: none"> ▪ Article 25 of Handling Procedures of Interest Rate Swap Business Rules

Item	Details	Remarks
<p>3. Participation in Auction in the Event of Default of Clearing Participant</p>	<p>according to liquidity.</p> <ul style="list-style-type: none"> ▪ For the Clearing Participants guaranteed by its Parent Company, etc. upon acquisition of the Clearing Qualification, the “Net Capital Amount” for this purpose shall be the Net Capital Amount of such Parent Company, etc. ▪ When JSCC takes measures of a suspension of Assumption of Obligations and Instructions for Improvement on positions holding, JSCC shall notify such effect to the Clearing Participants and also make a public announcement. ▪ When the Instructions for Improvement on positions holding as mentioned in (1) or (2) above are given, the Clearing Participant may request the Clearing Customers (in case of the Instructions for Improvement relating to (2), only such Clearing Customer subject to such Instructions for Improvement) for a reduction of their positions. ▪ A Clearing Participant may outsource a participation in auctions, and the Clearing Participant who outsourced the bid may satisfy its obligation to participate in auctions by the said outsourcee participating in the auction. 	<ul style="list-style-type: none"> • Article 37, Paragraph 3 of Interest Rate Swap Clearing Business Rules (hereinafter referred to as the “Business Rules”) • To be provided for in the Clearing Brokerage Agreement. • The priority in use of the Clearing Funds, etc. of the outsourcer Clearing Participant shall be determined based on whether or not the outsourcee has bid in the auction and its bid price. • The requirement for the acquisition of the Clearing Qualification of “maintaining a structure of execution of business which enables it to participate in the procedures for the settlement of Clearing Contracts entered into by a Clearing Participant in respect of whom default has

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		<p>occurred.” is considered to have been satisfied by maintaining by outsourcing.</p> <ul style="list-style-type: none"> ▪ Of “a structure of execution of business which enables it to participate in the procedures for settlement of Clearing Contracts entered into by a Clearing Participant in respect of whom default has occurred,” as to the structure for evaluating the auction portfolio and determining the bid price, having such structure in place by a utilization of external resources is permitted under the current structure (without resorting to the outsourcing structure to be newly introduced), which effect will be made clear in the guidelines concerning the criteria for acquisition of Clearing Qualification, etc. ▪ By introducing the outsourcing structure this time and clarifying that the satisfaction of the structure requirement by a utilization of external resources is permitted, the methods of maintaining the structure of execution of business which enables it to participate in the procedures for the settlement of Clearing Contracts entered into by a Clearing Participant in respect of whom default has occurred are as follows: (i) maintaining such structure by itself, (ii) utilizing the outsourcing structure, (iii) utilizing external resources for the evaluation of the

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(1) Details of Outsourcing	<ul style="list-style-type: none"> ▪ Matters that may be outsourced in respect of a participation in auctions shall be the evaluation of the auction portfolio, pricing for bidding in the auction, bidding and assumption of positions when the outsourcee wins the bid. 	<p>auction portfolio and the determination of the bid price, and (iv) building cooperative relationships with the affiliate.</p> <ul style="list-style-type: none"> ▪ If the auction is outsourced to the outsourcee, the participation in default settlement drills (fire drills) shall also be outsourced. ▪ Sending a representative to the IRS Default Management Committee will not be the matter to be outsourced. The current structure under which an officer or employee of a corporation, etc. included in the same Corporate Group, in addition to an officer or employee of the Clearing Participant, may be elected as the representative of the Default Management Committee shall be maintained.
(2) Scope, etc. of outsourcee	<ul style="list-style-type: none"> ▪ The outsourcee shall be other Clearing Participant. 	<ul style="list-style-type: none"> ▪ The outsourcing will be permitted on condition that the outsourcee has the business execution structures for participating in the auction in place and has not accepted outsourcing from other Clearing Participant. ▪ By outsourcing to the outsourcee which satisfies the above mentioned conditions, the Clearing Participant is considered to have the business execution structure relating to the participation in the auction in place.

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(3) Procedures for Outsourcing	<ul style="list-style-type: none"> ▪ An applicant for the Clearing Qualification who desires to outsource the participation in auctions from the outset of the acquisition of the Clearing Qualification shall clarify who the outsourcee is and state that the outsourcee has the structure for participating in the auction in place, in the application form for the acquisition of the Clearing Qualification. ▪ The outsourcer shall conclude an outsourcing agreement with the outsourcee. The outsourcing agreement shall contain the provisions prescribed by JSCC so that the outsourcee participates in auctions in an appropriate manner. ▪ A Clearing Participant who outsources the participation in auctions may change the outsourcee or cancel the outsourcing (participation in auctions by itself) when JSCC deems appropriate. Also, a Clearing Participant who has not outsourced the participation in auctions may outsource such participation. 	<ul style="list-style-type: none"> ▪ Upon the commencement of the client clearing, if clients will be permitted to participate in auctions, we will examine the outsourcing criteria in such direction that the client of the Clearing Participant is permitted as an outsourcee on condition that such client has the business execution structure for participating in auctions in place. ▪ Based on such document, etc., JSCC will determine whether or not to permit the outsource of the participation in auctions. ▪ The provisions prescribed by JSCC may be, for example, confidentiality obligations of the outsourcee and a method for avoiding a conflict of interests. ▪ JSCC will judge whether or not to permit a change of the outsourcee, etc. through similar procedures as at the time of the acquisition of the Clearing Qualification.

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(4) Securing Effectiveness	<ul style="list-style-type: none"> ▪ When outsourcing the participation in auctions, the participation in default settlement drills (fire drills) shall also be outsourced. ▪ If JSCC deems it necessary from the status of the outsourcee's participation in default settlement drills (fire drills) or in auctions, JSCC takes such measures as the Instructions for Improvement to the outsourcer Clearing Participant. 	<ul style="list-style-type: none"> ▪ Business Rules Article 28
4. Others	<ul style="list-style-type: none"> ▪ Upon request of CFTC, JSCC will submit materials relating to financial reporting submitted by IRS Clearing Participants other than FCM to CFTC. ▪ Upon request of CFTC, JSCC will submit materials relating to risk management for IRS (such as internal rules relating to the method of managing risk of loss) submitted by IRS Clearing Participant to CFTC. 	<ul style="list-style-type: none"> ▪ To be made clear in the rules. ▪ To be made clear in the rules.

III. Implementation Timing (Scheduled)

These amendments shall become effective as of such date as designated by JSCC (subject to the confirmation of CFTC and the approval from the Commissioner of the Financial Services Agency).

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Re: Measures of Raising Initial Margin in Risk Limits relating to Clearing Participant’s Proprietary and each Clearing Customer Accounts

- If the Required Initial Margin Amount for the Clearing Participant’s proprietary account exceeds 50% of its Net Capital Amount, then the Required Initial Margin Amount for the proprietary account of the relevant Clearing Participant shall be raised based on the following criteria.
- If the Required Initial Margin Amount for any of the Clearing Customers of a Clearing Participant exceeds 50% of the Net Capital Amount of the relevant Clearing Participant, the Required Initial Margin Amount for the Clearing Customer whose Required Initial Margin Amount has exceeded 50% of the Net Capital Amount shall be raised based on the following criteria.

Required Initial Margin Amount / Net Capital Amount of Clearing Participant (%)	Rate of Increase
Over 50% up to 60%	1.2
Over 60% up to 70%	1.4
Over 70% up to 80%	1.6
Over 80% up to 90%	1.8
Over 90% up to 100%	2.0
Over 100%	2.0 (Note)

(Note) In case of over 100%, the relevant Clearing Participant or the relevant Clearing Participant shall be subject to the measures of suspension of a new Assumption of Obligations and Instructions for Improvement of positions.

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