

Answers to the key questions of Recommendations for Central Counterparties (CCPs)

(Assessment of Compliance with the CPSS/IOSCO
“Recommendations for Central Counterparties”)

Mar. 26, 2012

The Japan Government Bond Clearing Corporation

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I. Introduction

1. Objective of this document

This document encompasses the results of a self-assessment by the Japan Government Bond Clearing Corporation as a central counterparty (CCP) of its observance of the *Recommendations for Central Counterparties* released by the Committee on Payment and Settlement Systems (CPSS) of the Bank for International Settlements (BIS) and the Technical Committee of the International Organization of Securities Commissions (IOSCO) in November 2004.

Responding institution: Japan Government Bond Clearing Corporation (as CCP)

Name of the entity assessed: Japan Government Bond Clearing Corporation

The information provided in the answers is accurate as of December 31, 2011.

This response can be found at [<http://www.jgbcc.co.jp/english/>].

Any enquiries should be sent to planning group (plan@jgbcc.co.jp).

2. Brief introduction to the CCP

Trade name	Japan Government Bond Clearing Corporation
Date of establishment	October 17, 2003 (Commencement of business: May 2, 2005)
Capital	JPY 2,474,344,052
Shareholders	Japan Securities Clearing Corporation: 35.63%; clearing participants or their Group companies: 64.37%

Board composition	full-time directors: 2, part-time directors: 7 (executives and/or employees of clearing participants) full-time auditors: 1, part-time auditors: 2 (executives and/or employees of clearing participants)																				
Scope of coverage	outright trading, trading with repurchase agreements and cash-collateralized securities lending of Japanese Government bonds in OTC markets																				
Past record (Daily average)	<table border="1"> <thead> <tr> <th></th> <th>2008</th> <th>2009</th> <th>2010</th> </tr> </thead> <tbody> <tr> <td>Amount of obligations assumed (face value, 1 billion yen)</td> <td>84,254</td> <td>69,231</td> <td>71,254</td> </tr> <tr> <td>Number of obligations assumed</td> <td>11,196</td> <td>9,269</td> <td>9,200</td> </tr> <tr> <td>DVP settlement volume (face value, 1 billion yen)</td> <td>20,311</td> <td>18,135</td> <td>18,593</td> </tr> <tr> <td>Number of DVP settlements</td> <td>5,467</td> <td>4,877</td> <td>4,897</td> </tr> </tbody> </table>		2008	2009	2010	Amount of obligations assumed (face value, 1 billion yen)	84,254	69,231	71,254	Number of obligations assumed	11,196	9,269	9,200	DVP settlement volume (face value, 1 billion yen)	20,311	18,135	18,593	Number of DVP settlements	5,467	4,877	4,897
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Clearing participants	securities companies: 25; banks: 5; cooperative financial institutions: 1; insurance companies: 0; securities finance companies: 1; call loan dealers: 3																				
Other services	Not applicable																				

3. Structure of Japanese government bonds market

a. Primary markets

Japanese government bonds (JGBs) regularly issued in Japanese primary markets currently comprise fixed-rate, floating-rate, inflation-indexed (with profit), and Treasury Bills (discount short-term bonds), as well as JGBs for retail investors (with profit). Of the foregoing, fixed-rate JGBs may be subject to STRIPS, or the separate trading of registered interest and principal securities. Japan Government Bond Clearing Corporation (hereinafter "JGBCC") does not deal in inflation-indexed bonds or JGBs for retail investors.

Since all JGBs issued in or after January 2003 and essentially all of those issued prior thereto have been dematerialized, everything from the issuance thereof to transfers, interest payments, and redemption are processed using the Bank of Japan JGB Book-Entry System.

The amount of JGBs issued in 2010 amounted to 165 trillion yen (66 bonds), with the outstanding balance as of the end of 2010 being 749 trillion yen (423 bonds).

The outstanding balance of JGBs on the basis of fund holders as of the end of 2010 included financial institutions (65.2%), pension funds (14.2%), Bank of Japan (8.0%), overseas (4.8%), and households (4.5%).

b. Secondary markets

Japanese secondary markets for JGBs are categorized into exchange markets and OTC markets. Of the foregoing, there is essentially no trade in the exchange markets, with most of the trading taking place in OTC markets.

Major types of OTC transactions in JGBs include outright trading, trading with repurchase agreements, and cash-collateralized securities lending. Of these, trading with repurchase agreements and cash-collateralized securities lending correspond to so-called *repo* transactions, having a trading aspect of securities transactions, as well as an aspect of short-term financial transactions practically collateralized by JGBs.

Principal entities trading in the OTC markets are securities companies, banks, domestic institutional investors, and overseas investors. Transactions between investors and brokers take place mainly through direct negotiations using the phone, e-mail, or other means. Transactions among brokers or dealers such as securities companies and banks are conducted based on negotiations via electronic trading systems operated by interdealer brokers or over the phone through interdealer brokers, as well as based on direct negotiations held individually using the phone, e-mail or other means.

OTC transaction volumes for 2010 were: outright trading - 3,393 trillion yen, trading with repurchase agreements - 4,060 trillion yen, and cash-collateralized securities lending - 8,835 trillion yen for a total of 16,288 trillion yen (25,123 trillion yen, when the start and end of cash-collateralized securities lending are totaled as separate transactions). Obligations that JGBCC assumed in 2010 amounted to 17,457 trillion yen, accounting for approximately 70% of OTC transactions. The share which accounts for DVP settlement amount in Bank of Japan of that of by JGBCC in 2010 is approximately 47%.

c. Clearance and settlement flows

Japan Securities Depository Center, Inc. operates the pre-settlement matching system that provides pre-contract matching and pre-settlement matching services relating to transactions among institutional investors, brokers, and dealers. JGBCC and JGBCC clearing participants are connected to the pre-settlement matching system, and JGBCC clears transactions that were matched using the pre-settlement matching system.

The settlement of government bonds and funds between clearing participants and JGBCC is conducted by means of account transfer under the Bank of Japan JGB Book-Entry System and by transfers to current accounts using the Bank of Japan Financial Network System (BOJ-NET) operated by the Bank of Japan.

II. Assessment of Observance (Summary)

- Of the applicable recommendations included in *Recommendations for Central Counterparties*, JGBCC concluded that Recommendations 1 to 4, 6 to 10 and 12 to 15 are "observed", and that Recommendation 5 is "broadly observed".

Assessment Category	Applicable Recommendations
Observed	Recommendation 1 (legal risk), Recommendation 2 (participation requirements), Recommendation 3 (measurement and management of credit exposures), Recommendation 4 (margin requirements), Recommendation 6 (default procedures), Recommendation 7 (custody and investment risks), Recommendation 8 (operational risk), Recommendation 9 (money settlements), Recommendation 10 (physical deliveries), Recommendation 12 (efficiency), Recommendation 13 (governance) , Recommendation 14 (transparency), Recommendation 15 (regulation and oversight)
Broadly observed	Recommendation 5 (financial resources)
Partly observed	None
Non-observed	None
Not applicable	Recommendation 11 (risks in links between CCPs)

III. Answers to the key questions of the recommendations

Recommendation 1: Legal risk

A CCP should have a well-founded, transparent and enforceable legal framework for each aspect of its activities in all relevant jurisdictions.

Answers to key questions

Key questions	Answers
<p>1. Are the laws and regulations governing the operation of a CCP and the rules, procedures, and contractual provisions for its participants, clearly stated, internally coherent, and readily accessible to participants and the public?</p>	<ul style="list-style-type: none"> • JGBCC is subject to regulation under the Companies Act as a stock corporation, as well as to regulation under the Financial Instruments Act as a CCP. • The contractual provisions between JGBCC and clearing participants are governed by JGBCC's business rules, as well as other rules stipulated by JGBCC. • JGBCC's business rules have been approved by the authorities and are consistent with the Companies Act and the Financial Instruments Act. • Since Japanese laws and ordinances are posted on government websites and JGBCC's rules are posted on the JGBCC website, they are easily accessible to clearing participants and the public.
<p>2. Does the legal framework demonstrate a high degree of assurance that there is a clear and effective legal basis for:</p> <p style="padding-left: 40px;">(a) The CCP to act as counterparty, including the legal basis for novation or open offer.</p> <p style="padding-left: 40px;">(b) The timing of assumption of liability as CCP.</p>	<ul style="list-style-type: none"> • The following are stipulated in JGBCC's business rules. The Financial Instruments Act requires that a CCP conduct its business operations in accordance with its business rules, and the business rules of a CCP are equivalent to legal regulations in nature. (a) JGBCC employs a method wherein it becomes a party to a transaction with the clearing participants by "assuming obligations". The "assumption of obligations" is recognized as being valid by judicial precedents and theories, and is stipulated in the Financial Instruments Acts as a method whereby a CCP becomes counterparty to a transaction. (b) The assumption of obligation is finalized by a contract between the relevant parties, and the timing of assumption is stipulated in the business rules, which

Key questions	Answers
<p>(c) Netting arrangements.</p> <p>(d) The CCP's interest in collateral (including margin) that a participant pledges or transfers to the CCP and prevents the defeat of such interest by the participant or a third party.</p> <p>(e) Default procedures.</p> <p>(f) Finality of transfers of funds and financial instruments.</p> <p>(g) Other significant aspects of the CCP's operations, risk management procedures and related rules.</p>	<p>represent a contract between JGBCC and a clearing participant.</p> <p>(c) JGBCC employs obligation netting, which is recognized as being legally valid, as the netting method.</p> <p>(d) Clearing funds (initial margin) that are deposits from clearing participants accepted by JGBCC are "clearing deposit" as defined in Article 156-11 of the Financial Instruments Act, and thus JGBCC has the right to receive payment from clearing funds in preference over other creditors. JGB deposited as substitute for cash is deposited by account transfer under the Bank of Japan JGB Book-Entry System, and account transfers under this system satisfy perfection requirements with respect to clearing participants, as well as third parties, pursuant to laws on the transfer of corporate bonds, stocks, and the like.</p> <p>(e) See Key Question 3</p> <p>(f) Finality is ensured for both fund transfers that are made via current accounts held at the Bank of Japan and JGB transfers that are made via the JGB Book-Entry System operated by the Bank of Japan.</p> <p>(g) The Financial Instruments Act requires that a CCP conduct its business operations in accordance with its business rules, and the business rules of a CCP are equivalent to legal regulations in nature.</p>
<p>3. Are the rules, procedures, and contracts of the CCP enforceable when a CCP participant defaults or becomes insolvent? Is there a high degree of assurance that actions taken under such rules and procedures may not later be stayed, avoided or reversed?</p>	<ul style="list-style-type: none"> • The Financial Instruments Act requires that a CCP conduct its business operations in accordance with its business rules, and the business rules of a CCP are equivalent to legal regulations in nature. • According to the Financial Instruments Act, if a CCP has provisions in its business rules on the settlement method for unsettled obligations, the provisions of the business rules are to be followed in the event special liquidation proceedings or the like are initiated with respect to a clearing participant. Hence, proceedings conducted in accordance with JGBCC business rules upon default of a clearing participant are deemed valid.
<p>4. Is there a significant level of cross-border participation in</p>	<ul style="list-style-type: none"> • Since JGBCC restricts the participant to those who have a branch in Japan,

Key questions	Answers
<p>the CCP? Has the CCP determined whether there are other jurisdictions relevant for determining the adequacy of the legal framework? Has the legal framework been evaluated for the other relevant jurisdictions? Do laws and rules support the design of any cross-border arrangement and provide adequate protection to both CCPs in the operation of the arrangement? Are there conflicts of laws issues and, if so, have they been addressed? Have cross-border collateral arrangements been evaluated?</p>	<p>cross-border participation is not assumed.</p>

ASSESSMENT: JGBCC observes Recommendation 1.

Recommendation 2: Participation requirements:

A CCP should require participants to have sufficient financial resources and robust operational capacity to meet obligations arising from participation in the CCP. A CCP should have procedures in place to monitor that participation requirements are met on an ongoing basis. A CCP's participation requirements should be objective, publicly disclosed, and permit fair and open access.

Answers to key questions

Key questions	Answers
<p>1. Does the CCP establish requirements for participants' financial resources and creditworthiness? How? What factors are considered (for example, size, clearing for indirect participants, products cleared)? Does the CCP assess participants' operational capability? How? What factors are considered (for example, arrangements to meet payment obligations, risk management policies, staffing, internal audit of risk controls and IT systems)?</p>	<ul style="list-style-type: none"> • JGBCC establishes capital, net assets, statutory capital adequacy ratio, and other financial criteria as participation requirements. • Financial requirements for qualification to clear transactions of other companies (qualification capable of clearing indirect participants) are stricter than those for qualification to clear self-transactions (qualification incapable of clearing indirect participants). • JGBCC requires that an entity have an appropriate internal system for business operations for participation. • When examining participation qualifications, JGBCC assesses the business management system, business operation system, internal rules on risk management and segregation of duties, and other necessary matters.
<p>2. Does the CCP monitor that participation requirements are met on an ongoing basis? How? Through access to regulatory reports or directly? Are reports sufficiently timely to be useful for monitoring purposes? Under what conditions can the CCP suspend and terminate participants' membership? What arrangements does the system have in place to facilitate the suspension and orderly exit of participants that no longer meet the participation requirements?</p>	<ul style="list-style-type: none"> • JGBCC monitors the participation requirement status of clearing participants by having them regularly submit various materials relating to the state of finances, business operations, the business management system, and the like. • Although a majority of the materials that JGBCC receives from clearing participants are the same as those that the participants submit to the supervisory authorities, some are prepared specifically for JGBCC. • JGBCC stipulates in its business rules the criteria for suspending the assumption of obligations by and revoking the clearing qualification of clearing participants. • JGBCC stipulates in its business rules a series of measures relating to the revocation of participation qualification to enable orderly exit of participants.

Key questions	Answers
<p>3. Do participation requirements limit access on grounds other than risks? Are they objective and do they permit fair and open access? Are participation requirements, including arrangements for orderly exit of participants, clearly stated and publicly disclosed?</p>	<ul style="list-style-type: none"> • The JGBCC stipulates objective criteria relating to a) the business management system, b) financial basis, and c) the business operation system. The Financial Instruments Act prohibits a CCP from treating a specific clearing participant in an unfair and discriminatory manner. • Rules on the orderly exit of participants and participation requirements are stipulated in the business rules and other rules, which are available on the JGBCC website.

ASSESSMENT: JGBCC observes Recommendation 2.

Recommendation 3: Measurement and management of credit exposures

A CCP should measure its credit exposures to its participants at least once a day. Through margin requirements, other risk control mechanisms or a combination of both, a CCP should limit its exposures to potential losses from defaults by its participants in normal market conditions so that the operations of the CCP would not be disrupted and non-defaulting participants would not be exposed to losses that they cannot anticipate or control.

Answers to key questions

Key questions	Answers
<p>1. How frequently does the CCP measure its exposures to its participants? Does the CCP have the capacity to measure exposures intra-day? How timely is the information on prices and positions that is used in these calculations?</p>	<ul style="list-style-type: none"> • JGBCC assumes obligation at 6:30p.m. daily (JST(UTC+9); the same applies hereinafter), concurrently measuring the fair value of unsettled positions of each clearing participant based on the market price of the day and calculating, with respect to each participant, the exposure and the amount required for deposit in the clearing fund (initial margin) on the following day. • Since JGBCC does not assume obligations on an intraday real-time basis, there is no increase in exposure attributable to day-time increase in unsettled positions. Meanwhile, in order to address the increase in exposure due to the volatility of JGBs, measures are in place to increase the amount of the clearing fund in accordance with intraday volatility (see Key Question 2 for Recommendation 4). • JGBCC is able to perform intraday real-time calculation of the (expected) amount required for deposit in the clearing fund on the following day based on transaction data received after 6:30p.m. of the previous day (transaction data for obligations to be assumed at 6:30p.m. that day).
<p>2. How does the CCP limit its exposures to potential losses from defaults by its Members? If margin requirements are used, does the CCP observe Recommendation 4? If not, how does the CCP ensure that closing out any participant's positions in normal market conditions would not disrupt the operations of the CCP or expose</p>	<ul style="list-style-type: none"> • JGBCC monitors the financial position of clearing participants on an ongoing basis and is able to suspend the assumption of obligation, in whole or in part, in the event that a clearing participant satisfies certain criteria. • JGBCC measures the fair value of unsettled positions of clearing participants on a daily basis, makes margin calls (give or receive variation margin), and receives deposits for the clearing fund (initial margin) in accordance with the potential loss

non-defaulting participants to losses that they cannot anticipate or control?	resulting from unsettled positions. • The clearing fund is in observance of Recommendation 4.
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ASSESSMENT: JGBCC observes Recommendation 3.

Recommendation 4: Margin requirements

If a CCP relies on margin requirements to limit its credit exposures to participants, those requirements should be sufficient to cover potential exposures in normal market conditions. The models and parameters used in setting margin requirements should be risk-based and reviewed regularly.

Answers to key questions

Key questions	Answers
<p>1. What is the intended coverage of margin requirements? What is the time interval over which potential price movements are measured? Is the interval consistent with a reasonable assumption about how quickly a defaulting participant's positions could be closed out? How does the CCP validate the models and parameters used to determine the margin levels consistent with the intended coverage? How frequently does it review and validate the models?</p>	<ul style="list-style-type: none"> • JGBCC receives deposits for the clearing fund (initial margin) from clearing participants in order to ensure that the clearing participants fulfill their obligations to JGBCC. • The clearing fund covers the risk that clearing participants will not settle funds only settlement in relation to daily revaluation, or the like, as well as price volatility risk in cases in which JGBs are not settled. • Among these, required amount for funds only settlement risk is average amount of funds only settlement amounts on top 20 days in the past 120 days. Required amount for price volatility risk covers more than 2σ (97.7%) of daily price changes as a result by setting some parameters conservatively, being based on calculating by the method of VaR. • JGBCC performs backtesting on a daily basis to validate the consistency of the clearing fund model and parameters. Should the results of a backtesting indicate potential problems with the model or the parameters, necessary revisions are considered.
<p>2. Does the CCP have the authority and operational capability to demand margin intra-day to maintain the desired coverage? Under what circumstances?</p>	<ul style="list-style-type: none"> • JGBCC increases the required amount of the clearing fund during the day in the event of significant intraday price fluctuation. • Specifically, JGBCC invokes measures to increase the amount of the fund in the event that the day-to-day fluctuation in the price of 10-year JGB futures as of the end of the morning session of the Tokyo Stock Exchange exceeds a certain figure established based on the risk factor for interest-bearing JGBs with current maturity

Key questions	Answers
	of more than 7 years and up to 10 years.
<p>3. What types of assets does the CCP accept as margin? What types are actually held? How frequently are the assets revalued? Are haircuts applied that adequately reflect the potential for declines in asset values between the last revaluation and liquidation?</p>	<ul style="list-style-type: none"> • There must be a minimum deposit of 500 million yen in cash (current account held at the Bank of Japan) in the clearing fund, the amount in excess of the 500 million yen may be substituted with JGBs. • JGB deposited as substitute for cash is revalued daily on the market value of the previous day and haircuts in accordance with current maturity.

ASSESSMENT: JGBCC observes Recommendation 4.

Recommendation 5: Financial resources

A CCP should maintain sufficient financial resources to withstand, at a minimum, a default by the participant to which it has the largest exposure in extreme but plausible market conditions.

Answers to key questions

Key questions	Answers
<p>1. Has the CCP established procedures to stress test its exposures in extreme but plausible market conditions? What scenarios are evaluated? Do the scenarios include the most volatile periods that have been experienced by the markets for which the CCP provides services? Does the CCP have sufficient resources in the event of default by the participant with the largest exposure? Has the potential for multiple simultaneous defaults been evaluated? Are stress tests performed at least monthly, with a comprehensive reconsideration of models, parameters and scenarios occurring at least annually? Does the CCP have a clear policy on actions to be taken in the event stress testing results indicate resources are not likely to be adequate to meet its obligations resulting from a default? Has it adhered to that policy? Is the policy made available to participants and authorities?</p>	<ul style="list-style-type: none"> • JGBCC performs stress testing to estimate the amount of loss that may be incurred in the event a clearing participant defaults in an extreme but plausible market conditions. • The stress scenarios require that the maximum fluctuation (increase and decrease) in interest rate over a given period in the past be applied to the actual daily position of each clearing participant. • JGBCC has loss compensation rules regarding defaulting clearing participants, in which a CCP "shall stipulate in its business rules that when a loss has been incurred due to Financial Instruments Clearing Services, a clearing participant shall bear all of said loss, and/or take other measures for securing the appropriate provision of Financial Instruments Clearing Services" pursuant to the stipulations of Article 156-10 of the Financial Instruments Act (see Key Question 2 for specific compensation rules). Thus, even if a clearing participant with the highest exposure defaults, it is possible to cover the loss. • Stress testing assumes the concurrent default of two participants that would result in maximum excess loss. • Stress testing is performed daily, and comprehensive stress testing is to be performed annually. • In accordance with the provisions of Article 156-10 of the Financial instruments Act, JGBCC stipulates in its business rules that when a CCP incurs loss, clearing participants shall bear all of the loss. The business rules are available on the JGBCC

Key questions	Answers
<p>2. What are the types and values of resources that the CCP has available to cover losses from participants' defaults? Is there a high degree of assurance that the CCP will be able to draw on those resources for the anticipated value in the event of a participant's default? Do the CCP's rules prohibit them from being used to cover operating losses or losses from other CCP activities?</p>	<p>website.</p> <ul style="list-style-type: none"> • Compensation for a loss incurred due to the default of a clearing participant takes place in the following order: <ul style="list-style-type: none"> (a) The assets (clearing fund, funds and JGBs expected to receive) of the defaulting clearing participant are used to compensate for the loss. (b) Should there be loss that cannot be fully compensated by means of (a) above, other clearing participants who traded with the defaulting clearing participant are required to bear a prorated portion of the loss. (c) Should there be loss that cannot be fully compensated by means of (a) and (b) above, a certain percentage of JGBCC's surplus is used to compensate. (d) Should there be loss that cannot be fully compensated by means of (a) through (c) above, other clearing participants are requested to bear a prorated portion of the loss. • Business rules state that the aforementioned financial resources can be used to cover for loss caused by the default of a clearing participant.
<p>3. Are any of the resources that the CCP is relying upon to cover losses from defaults not immediately available to meet the CCP's obligations? If so, has the CCP obtained committed credit lines subject only to presentment that allow it to borrow against those assets? If so, can those lines be drawn upon sufficiently quickly to ensure that the CCP can meet its obligations when due?</p>	<ul style="list-style-type: none"> • Of the financial resources listed in Key Question 2, the cash listed under (a) is managed in full in a current account held at the Bank of Japan and is available for immediate use. • Although it takes a certain number of days to sell the JGBs under (a) (the current settlement cycle is T + 3), they may be converted into cash on the same day by means of cash-collateralized securities lending. • Assets corresponding to JGBCC's surplus serving as the source for (c) are deposits with commercial banks and are available for immediate use. • It takes a certain amount of time to execute (b) and (d). • In order to secure liquid funds that are immediately available for use, JGBCC has an agreement with multiple clearing participants to provide liquidity through cash-collateralized securities lending for an amount totaling 200 billion yen. • Should the execution of the aforementioned agreements and other means still result

Key questions	Answers
	<p>in inadequate liquid funds, clearing participants engaged in transactions with the defaulting clearing participant have the obligation to provide liquidity to JGBCC through cash-collateralized securities lending.</p> <ul style="list-style-type: none"> As described above, JGBCC has a scheme in place for the procurement of liquid funds necessary in the event of default of a clearing participant. However, there are uncertainties regarding the feasibility of the scheme in the event of actual default.

ASSESSMENT: JGBCC broadly observes Recommendation 5.

Additional Comments: Since there are uncertainties regarding the feasibility of JGBCC's existing scheme in Key Question 3, the assessment for Recommendation 5 is "broadly observed". Accordingly, JGBCC recognizes the need to enhance its ability to procure liquid funds.

Recommendation 6: Default procedures

A CCP's default procedures should be clearly stated, and they should ensure that the CCP can take timely action to contain losses and liquidity pressures and to continue meeting its obligations. Key aspects of the default procedures should be publicly available.

Answers to key questions

Key questions	Answers
<p>1. Do the CCP's default procedures state clearly what constitutes a default? If a default occurs, do the CCP's default procedures provide it with authority to promptly close out or manage the positions of a defaulting participant and to apply the defaulting participant's collateral or other resources? Do the CCP's procedures, or mechanisms other than those of the CCP, permit the transfer or (as an alternative) liquidation of the positions and margin of customers of the defaulting participant? Do the procedures empower the CCP to draw promptly on any financial resources?</p>	<ul style="list-style-type: none"> • The business rules states clearly what constitutes a default. • JGBCC is able to suspend the assumption of obligations originating from the defaulting clearing participant, to promptly close out or manage the positions of the defaulting participant, dispose of collaterals pledged by the defaulting clearing participant, and take other actions pursuant to the stipulations of the business rules. • There are two categories in JGBCC's participation qualifications, one is to clear transactions of other companies and another is to clear only self-transactions. Participants with qualifications to clear transactions of other companies are obliged to manage transactions segregating those of other companies from self-transactions. • In the event that a clearing participant default, JGBCC may divert the cash deposited in the clearing fund by the defaulting clearing participant, as well as other participants, procure funds by collateralizing JGBs deposited as the clearing fund, and procure funds from clearing participants and other parties, pursuant to the provisions of the business rules.
<p>2. Does the legal framework provide a high degree of assurance that the decisions to liquidate or transfer a position, to apply margin or to draw down liquidity resources in the event of the insolvency of a participant would not be stayed or reversed? Does national insolvency law permit identification and separate treatment of customer and proprietary assets?</p>	<ul style="list-style-type: none"> • See Key Question 3 on Recommendation 1. • Japanese insolvency laws permit the identification and separate treatment of customer assets and proprietary assets.
<p>3. Does the CCP's management have internal plans for</p>	<ul style="list-style-type: none"> • JGBCC has a manual of default procedures. This manual ensures flexibility,

Key questions	Answers
<p>implementing its default procedures? Does the plan maintain a measure of flexibility for the CCP in deciding how best to implement its default procedures? Does the plan address the need for coordination in cases where more than one CCP, authority or a separate market operator is involved? How frequently is the plan reviewed?</p>	<p>including the selection of measures from among multiple alternatives in accordance with market conditions and other elements.</p> <ul style="list-style-type: none"> • Default procedures are to be implemented in close communication with authorities. It is not necessary to establish systems for coordination and/or communication with market operators, since JGBCC is not linked to any particular exchange. • Training is held regularly on default procedures, which are revised based on the training results.
<p>4. Are the key aspects of the default procedures publicly available?</p>	<ul style="list-style-type: none"> • Major points of the default procedures are stipulated in the business rules and are available on the JGBCC website.

ASSESSMENT: JGBCC observes Recommendation 6.

Recommendation 7: Custody and investment risks

A CCP should hold assets in a manner whereby risk of loss or of delay in its access to them is minimised. Assets invested by a CCP should be held in instruments with minimal credit, market and liquidity risks.

Answers to key questions

Key questions	Answers
1. At what types of entities is collateral held? Does the CCP verify that these entities' procedures and practices conform to Recommendation 12 of the RSSS? How? Does the CCP confirm that its interest in the securities can be enforced and that it can have prompt access to the securities in the event of a participant's default, even if these securities are held in another time zone or jurisdiction? Does it monitor the financial condition of its custodians on an ongoing basis?	<ul style="list-style-type: none">• The cash and JGBs for the clearing fund are maintained in the JGBCC's account held with the Bank of Japan.• It was confirmed that in the self-assessment regarding <i>Recommendations for Securities Settlement Systems</i>, the Bank of Japan concluded that Recommendation 12 is "Observed".• Collateral securities are held in the same time zone and within the same jurisdiction.• Since they are held by the central bank, JGBCC does not monitor the financial position of the bank.
2. How is cash invested? Are investments secured? What standard does the CCP use to ensure that obligors are highly creditworthy? What standard does the CCP use to ensure that investments have minimal market and liquidity risks?	<ul style="list-style-type: none">• JGBCC does not invest cash.
3. Does the CCP consider its overall exposure to an obligor in choosing investments? Are investments limited to avoid concentration of credit risk exposures? How?	<ul style="list-style-type: none">• Same as above.

ASSESSMENT: JGBCC observes Recommendation 7.

Recommendation 8: Operational risk

A CCP should identify sources of operational risk and minimise them through the development of appropriate systems, controls and procedures. Systems should be reliable and secure, and have adequate, scalable capacity. Business continuity plans should allow for timely recovery of operations and fulfilment of a CCP's obligations.

Answers to key questions

Key questions	Answers
<p>1. Does the CCP have a process for actively identifying, analysing and addressing its operational risk, including risks arising from its outsourced operations and its other activities?</p>	<ul style="list-style-type: none"> • JGBCC minimises the operational risk by establishing the information system which enable automatic processing of almost all operations, such as reception of transaction data, assumption of obligation, netting, calculation of required amount of the clearing fund, generation of settlement data, distribution of netting and settlement data to clearing participants, transmission and reception of settlement data with Bank of Japan, • JGBCC addresses risks in accordance with the risk management cycle, identifying and analyzing overall risks, including operational risks, pursuant to the risk management rules.
<p>2. Does the CCP have a business continuity plan that addresses events posing a significant risk of disrupting operations? Do plans ensure that critical information can be recovered in a timely manner? Do plans provide, at a minimum, for the recovery of all transactions at the time of the disruption to allow systems to continue to operate with certainty? Is the business continuity plan regularly reviewed and tested with participants? Have appropriate adjustments to operations been made based on the results of such exercises?</p>	<ul style="list-style-type: none"> • JGBCC has a business continuity plan in place for implementation in the event of disasters, system failures, and other disruptions. • In preparation for the continuation of business in the event of disruptions, data is stored both at the primary center and the backup center to allow for a prompt switch-over to the backup center in the event of failure at the primary center. • JGBCC regularly conducts various internal drills, as well as drills involving clearing participants for familiarization with switch-over to the backup center. JGBCC revises the rules and the manual as necessary, based on the drill results.
<p>3. Are there adequate management controls and sufficient (and sufficiently well qualified) personnel to ensure that</p>	<ul style="list-style-type: none"> • The JGBCC Board of Directors has established a "Basic Internal Control Policy" (a policy on the establishment of systems and structures for ensuring the

Key questions	Answers
<p>procedures are implemented appropriately? Are operational reliability issues reviewed regularly by senior management, including review by persons not responsible for the relevant operations? Is there an internal audit function and does it review operational risk controls?</p>	<p>appropriateness of business operations) pursuant to the Companies Act. Pursuant to this policy, JGBCC established a Comprehensive Risk Management Committee to monitor the state of risk management, in addition to assigning personnel necessary for the execution of business operations.</p> <ul style="list-style-type: none"> • The Comprehensive Risk Management Committee regularly devises improvement plans based on the results of risk analyses relating to JGBCC's business operations and monitors the implementation of the improvement plans. • JGBCC has an independent internal audit department that conducts internal audits on the status of operational risk and other risk management.
<p>4. How many times during the last year has a key system failed? What is the most common cause of failures? How long did it take to resume processing? How much transaction data, if any, was lost? How does the CCP ensure the integrity of messages? Does the CCP have capacity plans for key systems and are key systems tested periodically to determine if they can handle stress volume?</p>	<ul style="list-style-type: none"> • There has been no failure in the past that disrupted business operations. • System capacity and the actual number of transactions processed are constantly monitored. • Redundant lines are used to connect the primary center and the backup center, as well as the centers and the destination systems. The data stored at the primary center and the backup center are subject to real-time synchronization, and the database at the primary center is backed up daily. • When major system changes or changes in the number of users are expected, the processing capacity is configured on the basis of expected business volume and necessary tests are performed. In addition, system capacity and the actual number of transactions processed are constantly monitored and are revised as necessary.

ASSESSMENT: JGBCC observes Recommendation 8.

Recommendation 9: Money settlements

A CCP should employ money settlement arrangements that eliminate or strictly limit its settlement bank risks, that is, its credit and liquidity risks from the use of banks to effect money settlements with its participants. Funds transfers to a CCP should be final when effected.

Answers to key questions

Key questions	Answers
1. Does the CCP use the central bank model or the private settlement bank model?	<ul style="list-style-type: none"> • JGBCC applies the central bank model.
2. Do the CCP's legal agreements with its settlement bank or banks provide that funds transfers to its accounts are final when effected? Do the laws of the relevant jurisdictions support these provisions? Do the payment systems for the currencies used support intraday finality? Does the CCP routinely confirm that funds transfers have been effected as and when required by those agreements?	<ul style="list-style-type: none"> • JGBCC settles funds by means of transfers using the current account held with the Bank of Japan. • Contracts between the Bank of Japan and its users provide that a settlement instruction is always unconditional and becomes irrevocable when it is accepted by the Bank of Japan in the case of FOP settlement. It further provides that, when both a JGB transfer instruction and the corresponding funds transfer instruction are accepted by the Bank of Japan, they become irrevocable in the case of DVP settlement. • The current account rules and other related rules of the Bank of Japan are deemed to be legally valid. • The Bank of Japan provides settlement services with real-time intraday finality. • Each time an intraday fund transfer is executed, JGBCC receives a notice of the transfer result and checks it, through an online real-time system connection between JGBCC and the Bank of Japan.
3. If the private settlement bank model is used, does the CCP establish and monitor strict criteria for the banks used that address their creditworthiness, access to liquidity, and operational reliability?	Not applicable.
4. If the private settlement bank model is used, does the CCP actively monitor the concentration of exposures	Not applicable.

Key questions	Answers
among the settlement banks, and routinely assess its potential losses and liquidity pressures from a settlement bank's failure?	

ASSESSMENT: JGBCC observes Recommendation 9.

Recommendation 10: Physical deliveries

A CCP should clearly state its obligations with respect to physical deliveries. The risks from these obligations should be identified and managed.

Answers to key questions

Key questions	Answers
1. Does the CCP have rules that clearly state its obligations with respect to deliveries of physical instruments?	<ul style="list-style-type: none">• The obligations relating to the deliveries of JGBs between JGBCC and clearing participants are stipulated in the business rules.
2. Does the CCP have obligations to make or receive deliveries of physical instruments? If yes, does the CCP use DVP mechanisms that eliminate principal risk? If no DVP mechanism is available, does the CCP take other steps to mitigate principal risk?	<ul style="list-style-type: none">• JGBCC has the obligation to make and receive deliveries of JGBs.• With regards to the transfer of JGBs, the principal risk is eliminated by using the DVP system provided by the Bank of Japan.
3. Has the CCP identified the liquidity, storage and delivery (other than principal) risks to which it is exposed because of the delivery obligations that it assumes? Does the CCP take steps to mitigate these risks? What steps does it take?	<ul style="list-style-type: none">• When the clearing participant does not deliver JGBs to JGBCC, JGBCC defers the settlement between the delivering participant and JGBCC, as well as the settlement corresponding thereto between JGBCC and the receiving participant, to the following business day or later. Thus, JGBCC is not exposed to liquidity risk with respect to JGBs.• There is no risk related to the storage and transfer of JGBs, as they have been dematerialized.

ASSESSMENT: JGBCC observes Recommendation 10.

Recommendation 11: Risks in links between CCPs

CCPs that establish links either cross-border or domestically to clear trades should evaluate the potential sources of risks that can arise, and ensure that the risks are managed prudently on an ongoing basis. There should be a framework for co-operation and co-ordination between the relevant regulators and overseers.

Answers to key questions

Key questions	Answers
1. What kinds of link are in operation? Has the CCP carried out a risk analysis of the potential sources of risks arising from the link? Are the resultant risk management arrangements designed to minimise or contain these risks, such that the CCP remains able to observe the other recommendations contained in this report?	<ul style="list-style-type: none"> · There are no links established between JGBCC and other CCPs
2. Which laws and contractual rules govern the link? What steps have the CCPs taken to satisfy themselves that these laws and rules support the design of the link and provide adequate protection to both CCPs in the operation of the link?	Not applicable.
3. What are the potential sources of operational, credit and liquidity risks arising from the link? Are effective mechanisms in place, including arrangements between the linked CCPs, to monitor and manage the risks identified?	Not applicable.
4. For the purposes of regulation and oversight of the link, is there a framework for co-operation and co-ordination between the relevant regulatory and oversight authorities, including provisions on information sharing and the division of responsibilities in the event of any	Not applicable.

Key questions	Answers
need for co-ordinated regulatory action?	

ASSESSMENT: JGBCC observes Recommendation 11.

Recommendation 12: Efficiency

While maintaining safe and secure operations, CCPs should be cost-effective in meeting the requirements of participants.

Answers to key questions

Key questions	Answers
1. Does the CCP have in place procedures to control costs (for example, by benchmarking its costs and charges against other CCPs that provide a similar service and by analysing the reasons for significant differences)? Does the CCP have in place procedures to regularly review its pricing levels against its costs of operation?	<ul style="list-style-type: none">• JGBCC has a system that ensures adequate cost management, which includes regular reports to clearing participants on the state of business operations and the balance of payments.• JGBCC revises the fee schedule as necessary, with due consideration of business conditions.
2. Does the CCP regularly review its service levels, (for example, by surveying its participants)? Does the CCP have in place procedures to regularly review operational reliability, including its capacity levels against projected demand?	<ul style="list-style-type: none">• JGBCC has a steering committee, which comprises members from all clearing participants, that meets regularly to operate business based on user needs.• When major system changes or changes in the number of users are expected, the processing capacity is configured on the basis of expected business volume over the next five years and systems are developed. System capacity and the actual number of transactions processed are constantly monitored and are revised as necessary.

ASSESSMENT: JGBCC observes Recommendation 12.

Recommendation 13: Governance

Governance arrangements for a CCP should be clear, and transparent to fulfil public interest requirements and to support the objectives of owners and participants. In particular, they should promote the effectiveness of a CCP's risk management procedures.

Answers to key questions

Key questions	Answers
<p>1. What are the governance arrangements for the CCP? What information is publicly available about the CCP, its ownership and its board and management structure?</p>	<ul style="list-style-type: none"> • JGBCC is subject to governance-related regulation under the Companies Act as a stock corporation, as well as to governance-related regulation under the Financial Instruments Act as a CCP. • One of the fundamental management policies of JGBCC is to "provide user-oriented high quality services". Pursuant to the policy, JGBCC bases itself on capital contributions from clearing participants, while at the same time receiving capital contributions from the Japan Securities Clearing Corporation from the perspective of establishing a cooperative business relationship therewith. • Of the nine members of the Board of Directors, seven are part-time directors and of the three members of the auditors, two are part-time auditors. All the part-time board members are executives and/or employees of clearing participants, • The fundamental management policies of JGBCC, along with lists of shareholders and board members , are available on the JGBCC website.
<p>2. Is there a clear separation in the reporting lines between risk management and other operations of the CCP? How is this separation achieved? Is there an independent risk management committee?</p>	<ul style="list-style-type: none"> • Risk management is handled by the Risk Management Group, which is an organization that is separate from groups responsible for other business operations. • A Comprehensive Risk Management Committee has been established separately from the management meeting, which makes decisions and holds discussions related to the execution of business operations. Outline of the discussion in the Comprehensive Risk Management Committee is reported to the Board of Directors.
<p>3. What steps are taken to ensure that management and the Board have the adequate skills and incentives to achieve the CCP's objectives of delivering sound and</p>	<ul style="list-style-type: none"> • The Financial Instruments Act requires that the personnel structure of a CCP be such that the individuals "have the knowledge and experience for accurately and fairly performing financial instruments clearing services and have sufficient social

Key questions	Answers
<p>effective services and to meet related public interest requirements? What are the mechanisms the Board has in place to ensure the objectives include delivering sound risk management and meeting related public interest requirements? How are management and the Board made accountable for their performance? How is the composition of the Board determined? Are there mechanisms to ensure that the Board contains suitable expertise and takes account of all relevant interests? Are reporting lines between management and the Board clear and direct? Is the Board responsible for selecting, evaluating, and if necessary removing senior management?</p>	<p>credibility," and the Board of Directors is composed of such individuals.</p> <ul style="list-style-type: none"> • Business performance is explained to clearing participants each fiscal year at the general meeting of shareholders and on a quarterly basis at steering committee meetings. • The steering committee, which consists of executives and/or employees of clearing participants, was established as an advisory body for the Board of Directors in order to provide user-oriented high quality services. • The management reports directly to the Board of Directors, which meets at least once every three months (normally once monthly). • The Board of Directors has the authority to elect and dismiss representative directors and executive directors from among the Board members. The dismissal of a director is subject to the resolution of the general meeting of shareholders pursuant to the Companies Act.
<p>4. Are the CCP's objectives, those responsible for meeting them and the extent to which they have been met disclosed to owners, participants, and public authorities? What are they?</p>	<ul style="list-style-type: none"> • The management philosophy, fundamental management policies, medium-term business plan, and business reports are available on the JGBCC website.

ASSESSMENT: JGBCC observes Recommendation 13.

Recommendation 14: Transparency

A CCP should provide market participants with sufficient information for them to identify and evaluate accurately the risks and costs associated with using its services.

Answers to key questions

Key questions	Answers
<p>1. Does the CCP disclose to market participants its rules, regulations, relevant laws, governance procedures, risks, steps taken to mitigate risks, the rights and obligations of participants and the costs of using the CCP services? Does the CCP make clear when and in what circumstances it assumes counterparty exposure and any restriction or limitations on its fulfilment of its obligations? Does the CCP disclose appropriate quantitative information on its clearing, netting, and settlement activities? Does the CCP provide market participants with sufficient information on default procedures and stress testing?</p>	<ul style="list-style-type: none"> • JGBCC has stipulated risks, risk reduction measures, the rights and obligations of clearing participants, costs related to the use of the CCP services, the timing and conditions for assuming the exposure of clearing participants, limitations and restrictions of obligations, default procedures, and the like in its business rules and other rules, which are available on the JGBCC website. • JGBCC posts the amount of obligations assumed, the amount settled, the status of failed settlements, the netting effect ratio, and other statistics monthly on the JGBCC website. • Information on stress testing is managed internally.
<p>2. How is information made available? In what language or languages? In what form?</p>	<ul style="list-style-type: none"> • The information is available in Japanese and partly in English on its website.
<p>3. Has the CCP completed and disclosed key questions set out in this report? Are there regular reviews to ensure that the information contained in the disclosures remains current, complete and accurate?</p>	<ul style="list-style-type: none"> • Although JGBCC has not released its answers to the key questions thus far, it is currently making preparations to do so.

ASSESSMENT: JGBCC observes Recommendation 14.

Recommendation 15: Regulation and oversight

A CCP should be subject to transparent and effective regulation and oversight. In both a domestic and international context, central banks and securities regulators should cooperate with each other and with other relevant authorities.

Answers to Key questions

Key questions	Answers
<p>1. How is the CCP regulated/overseen? Describe the laws that authorise and govern the CCP's operation, the applicable regulatory bodies and their respective authority for the CCP's operation. Do the securities regulator and central bank have sufficient legal capacity and resources (including experienced staff and funding) to carry out effective regulation and oversight?</p>	<ul style="list-style-type: none"> • JGBCC is licensed and supervised by the Japanese Prime Minister (a part of the authority has been delegated to the Financial Services Agency) pursuant to the Financial Instruments Act. The Japanese Prime Minister may issue business improvement orders, as well as revoke licenses, with respect to the JGBCC (a part of the authority has been delegated to the Financial Services Agency). The Japanese Prime Minister may order JGBCC to submit reports and documents, and may conduct on-site inspections (a part of the authority has been delegated to the Financial Services Agency and the Securities and Exchange Surveillance Commission). • JGBCC is overseen by the Bank of Japan as a CCP for OTC trading of JGBs. The Bank of Japan provides oversight in order to achieve the purpose thereof as stipulated in Article 1 Paragraph 2 of the Bank of Japan Act, which is to "ensure smooth settlement of funds among banks and other financial institutions". • JGBCC uses its current account with the Bank of Japan and the JGB Book-Entry System to settle funds and JGBs. Accordingly, it provides information to the Bank of Japan and is subject to inspections thereby pursuant to its contract with the Bank of Japan.
<p>2. Are the objectives, responsibilities and main policies of the securities regulator, central bank and, where relevant, banking supervisor, clearly defined and publicly disclosed? Are the regulations, roles and policies written in plain language so that they may be fully understood by</p>	<ul style="list-style-type: none"> • The goals and responsibilities relating to the supervision of central counterparties are stipulated by the Financial Instruments Act and the Cabinet Office Ordinance on Financial Instruments Clearing Organizations, etc., which are both available to the public. • The purpose of oversight, the roles, action policies, and other matters relating to the

Key questions	Answers
CCPs and their participants?	Bank of Japan are clearly defined in the "Policy on Oversight of Payment and Settlement Systems", which the Bank of Japan issued in May 2010.
3. What information is the CCP required to provide, including information on operations that have been outsourced? How frequently is this information provided? Are there specific information requirements for participants' defaults and CCP financial difficulties? Is the CCP required to report significant events, such as rule changes, outages, and changes in risk management procedures?	<ul style="list-style-type: none"> • The Financial Instruments Act and the Cabinet Office Ordinance on Financial Instruments Clearing Organizations, etc. provide for the submission to supervisory authorities of an application for authorization of amendments to business rules (as needed), notification of amendments or abolition of regulations pursuant to the business rules (as needed), notification of changes in the amount of capital and/or corporate officers (as needed), financial statements (each fiscal year), reports on accidents (as needed), and the like.
4. Is there a framework for cooperation between relevant authorities for the CCP, including domestic and non-domestic? If so, describe the principles underlying this/these framework(s) and their main contents, including any information-sharing arrangements and decision-making procedures.	<ul style="list-style-type: none"> • JGBCC recognizes that the Financial Services Agency and the Bank of Japan remain close contact with each other, routinely exchanging information and opinions. • The Financial Instruments Act stipulates that the Prime Minister may seek the opinion of the Bank of Japan should there be a need to take administrative action against a CCP subject to the Act.

ASSESSMENT: JGBCC observes Recommendation 15.

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