

B.11.3 Clearing Agencies

B.11.3.1 Japan Securities Clearing Corporation – Application for Exemption from Recognition as a Clearing Agency – OSC Notice and Request for Comment

OSC NOTICE AND REQUEST FOR COMMENT

APPLICATION FOR EXEMPTION FROM RECOGNITION AS A CLEARING AGENCY

JAPAN SECURITIES CLEARING CORPORATION

A. Background

The Japan Securities Clearing Corporation (**JSCC**) has applied (the **Application**) to the Commission for an order pursuant to section 147 of the *Securities Act* (Ontario) (**OSA**) to exempt it from the requirement to be recognized as a clearing agency pursuant to subsection 21.2(0.1) of the OSA.

JSCC is a joint-stock company formed under the *Companies Act* of Japan and is a majority-owned subsidiary of the Japan Exchange Group, Inc., a publicly traded company listed on the Tokyo Stock Exchange.

JSCC is licensed as a central counterparty (**CCP**) to perform clearing services under the *Financial Instruments and Exchange Act* (Japan). JSCC is recognized by the European Securities and Markets Authority as a Third Country CCP under the *European Market Infrastructure Regulation* and is subject to an order issued by the U.S. Commodity Futures Trading Commission that exempts JSCC from the requirement to register as a Derivatives Clearing Organization under the U.S. *Commodity Exchange Act*. JSCC is also an authorized CCP in Switzerland and Hong Kong and is designated as a “prescribed facility” in Australia. JSCC has obtained temporary recognition from the Bank of England as a Third Country CCP under applicable EU Exit regulations.

JSCC proposes to offer access to its clearing and settlement facilities for Interest Rate Swaps (**IRS**) to prospective participants in Ontario, either directly or through an intermediary.

To carry on business in Ontario, JSCC must be recognized as a clearing agency under the OSA or apply for an exemption from the recognition requirement. Among other factors set out in the Application, JSCC is seeking an exemption from the recognition requirement on the basis that it is subject to an appropriate regulatory and oversight regime in its home jurisdiction of Japan by the Japanese Financial Service Agency (**JFSA**) and the Bank of Japan.

JSCC is currently subject to an interim clearing exemption order (**Interim Order**) allowing it to provide IRS clearing services to Ontario customers through a foreign clearing participant that is a direct clearing intermediary pursuant to National Instrument 94-102 *Derivatives: Customer Clearing and Protection of Customer Collateral and Positions* (**NI 94-102**). The Interim Order was granted on September 29, 2023, and will expire on September 28, 2024.

JSCC is also subject to certain requirements in NI 94-102. On October 2, 2023, the OSC issued an [order](#) exempting JSCC from certain provisions of NI 94-102 (the **NI 94-102 Exemption Order**) on the basis of substituted compliance. As a result of the NI 94-102 Exemption Order, certain foreign entities clearing OTC derivatives for “local customers” as defined in NI 94-102 will be eligible for substituted compliance under Part 9 of the rule.

B. Application and Draft Exemption Order

In the Application, JSCC describes its requirements under applicable Japanese laws and regulations that are generally comparable or that achieve similar outcomes to the requirements of National Instrument 24-102 *Clearing Agency Requirements* (**NI 24-102**). Subject to comments received, Staff propose to recommend to the Commission that it grant JSCC an exemption order in the form of the proposed draft order attached at Appendix A (**Draft Order**). Staff are prepared to recommend to the Commission that it exempt JSCC because it does not currently pose significant risk to Ontario's capital markets and is subject to an appropriate regulatory and oversight regime in another jurisdiction by its home regulator.

In determining whether a clearing agency poses significant risk to Ontario, Staff consider the level of activity of the clearing agency in Ontario (using indicators such as notional value and volume of transactions cleared for Ontario-based market participants) and other qualitative and quantitative factors, such as interconnectedness, size of obligations and the role and central importance of a clearing agency to a particular market.

The Draft Order requires JSCC to comply with various terms and conditions set forth in Schedule "A" to the Draft Order, including with respect to:

1. Regulation of JSCC
2. Governance

3. Permitted scope of clearing activities in Ontario
4. Filing requirements
5. Information sharing

The Draft Order also acknowledges that the scope of the terms and conditions imposed by the Commission, or the determination as to whether it is appropriate that JSCC continue to be exempted from the requirement to be recognized as a clearing agency, may change as a result of the Commission's monitoring of developments in international and domestic capital markets, JSCC's activities or regulatory status, or as a result of any changes to the laws in Japan or Ontario affecting trading in or clearing and settlement of derivatives or securities.

C. Comment Process

The Commission is publishing for public comment JSCC's Application and Draft Order. We are seeking comment on all aspects of the Application and Draft Order.

Please provide your comments in writing, via e-mail, on or before **August 17, 2024**, to the attention of:

Ontario Securities Commission
20 Queen Street West
22nd Floor
Toronto, Ontario M5H 3S8
Email: comments@osc.ca

The confidentiality of submissions cannot be maintained as the comment letters and a summary of written comments received during the comment period will be published.

Questions may be referred to:

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July 1, 2024

VIA EMAIL

Ontario Securities Commission
23 Queen Street West, 22nd Floor
Toronto, ON M5H 3S8

Dear Sirs/Mesdames:

RE: Japan Securities Clearing Corporation

Re: Application for an Exemption from Recognition as a Clearing Agency

We are acting as counsel to Japan Securities Clearing Corporation (“**JSCC**”) in connection with its application, pursuant to section 147 of the *Securities Act* (Ontario) (the “**Act**”) and National Instrument 24-102 *Clearing Agency Requirements* (“**NI 24-102**”), for an order (the “**Exemption Order**”) exempting JSCC from the requirement to obtain recognition as a clearing agency under section 21.2 of the Act in order to provide its central counterparty (“**CCP**”) service for interest rate swaps (“**IRS**”) to Ontario market participants.

Statements set out herein regarding JSCC’s history, operations, regulatory status and objectives and regarding applicable Japanese laws and JSCC requirements are based on statements made and certified to Blake, Cassels & Graydon LLP for the purpose of preparing this application letter.

1. Background

- 1.1 JSCC was established as a joint-stock company under the *Companies Act* of Japan (the “**Companies Act**”) on July 1, 2002. Its registered and head office is located at 2-1 Nihombashi Kabutocho, Chuo-ku, Tokyo 103-0026 Japan. JSCC was licensed as a central counterparty on January 7, 2003, making it the first licensed clearing organization in Japan. JSCC’s website is at: <https://www.jpx.co.jp/jscce/en/>.
- 1.2 JSCC provides clearing services for transactions in four business lines distinguished by financial product types (each, a “**Clearing Business**”): (i) “**Listed Products**,” comprised of equity, debt and other securities sold in the cash market that are listed on Tokyo Stock Exchange, Inc. (“**TSE**”) and other exchanges and proprietary trading systems (“**PTS**”) in Japan (“**Cash Products**”), financial derivatives listed and traded on Osaka Exchange, Inc. (“**OSE**”), and commodity derivatives listed and traded on commodity markets at OSE, Tokyo Commodity Exchange, Inc. (“**TOCOM**”) and Osaka Dojima Exchange, Inc. (“**ODEX**”); (ii) credit default swaps (“**CDS**”); (iii) IRS; (iv) and OTC Japanese Government Bond (“**JGB**”) transactions.
- 1.3 Each of JSCC’s Clearing Businesses has its own separate share structure, Business Rules, financial resources for default management, and JSCC’s own capital contributions for default resources and to manage on-going business operations. Under this structure, JSCC ensures that each Clearing Business is segregated from and has no impact on any other Clearing Business, even in the event of a default of a Clearing Participant clearing transactions in multiple Clearing Businesses.
- 1.4 As of December 31, 2023, JSCC serves 26 Clearing Participants for IRS. JSCC cleared JPY 2,012 trillion of IRS in 2023.
- 1.5 JSCC is licensed to perform clearing services (“Financial Instruments Obligation Assumption Services”) under Japan’s *Financial Instruments and Exchange Act* (“**FIEA**”) and to perform clearing services (“Business of Assuming Commodity Transaction Debts”) under Japan’s *Commodity Derivatives Act* (“**CDA**”). JSCC is directly regulated by the Japanese Financial Services Agency (“**JFSA**”), the Japanese government agency responsible for ensuring the stability of Japan’s financial system, investor protection and market surveillance of securities transactions. JSCC is also directly regulated by the Ministry of Agriculture, Forestry and Fisheries (“**MAFF**”) and the Ministry of Economy, Trade and Industry (“**METI**”) in respect of its clearing services for commodity derivatives transactions.

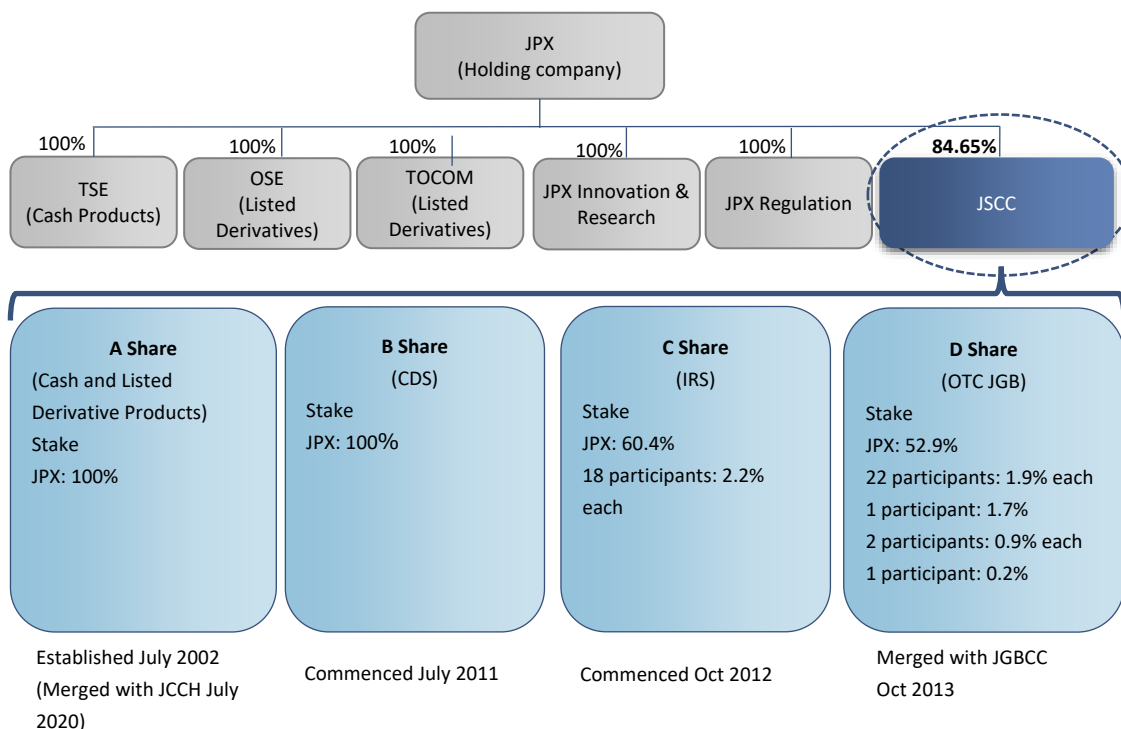
- 1.6 JSCC is subject to the Comprehensive Guidelines for Supervision of Financial Market Infrastructures (the “**CCP Supervisory Guidelines**”) published by the JFSA, which is a binding supervisory guideline promulgated by the JFSA under the FIEA. The CCP Supervisory Guidelines incorporate into Japanese regulations the Principles for Financial Market Infrastructures (“**PFMI**”) published by the then Committee on Payment and Settlement Systems (now Committee on Payments and Market Infrastructures) of the Board of the International Organization of Securities Commissions (“**CPMI-IOSCO**”). JSCC is also subject to the Basic Guidelines on Supervision of Commodity Clearing Organizations published by the MAFF and the METI. JSCC is subject to oversight¹ by the Bank of Japan (“**BOJ**”) of financial market infrastructures, as provided in Article 1 of the *Bank of Japan Act*. JSCC is fully compliant with the PFMI and the CCP Supervisory Guidelines.
- 1.7 As a vital financial market infrastructure (“**FMI**”) in Japan, JSCC employs a governance structure designed to ensure fairness and robust risk management. JSCC’s corporate philosophy (the “**Corporate Philosophy**”) is as follows: “JSCC, with a solid risk-management framework, aims to contribute to sustainable development of the markets by improving the efficiency, serviceability and safety of the markets as post-trade processing infrastructure”. The Corporate Philosophy is published at <https://www.jpx.co.jp/jscce/en/company/philosophy.html>.
- 1.8 The rules governing Clearing Participants and the clearing of IRS transactions at JSCC are the Interest Rate Swap Clearing Business Rules (the “**IRS Business Rules**”), which are available at https://www.jpx.co.jp/jscce/en/rule/rule_irs.html. Certain capitalized terms that appear in this application and that are not defined in this application are defined in the IRS Business Rules.
- 1.9 On September 29, 2023, the Ontario Securities Commission (“**OSC**”) issued an interim order (the “**Interim Exemption Order**”) exempting JSCC from the requirement to obtain recognition as a clearing agency under section 21.2 of the Act in order to provide its CCP service for IRS to Canadian banks listed on Schedule I to the *Bank Act* (Canada) (each, a “**Schedule I Bank**”). The Interim Exemption Order terminates on the earlier of (i) September 28th, 2024 and (ii) the effective date of the Exemption Order that is the subject of this application letter.
- 1.10 On October 2, 2023, the OSC issued an order (the “**94-102 Exemption Order**”) exempting JSCC from certain provisions of National Instrument 94-102 *Customer Clearing and Protection of Customer Collateral and Positions* (“**NI 94-102**”), in order to permit JSCC to rely on comparable Japanese rules applicable to clearing agencies in lieu of complying with the provisions of NI 94-102 applicable to regulated clearing agencies. Accordingly, JSCC is a “regulated clearing agency” as defined in NI 94-102 and therefore certain non-Canadian Clearing Participants that clear OTC derivatives for entities that have a head office or principal place of business in Ontario and that are “local customers” as defined in NI 94-102 (each an “**Ontario Customer**”) will be eligible for substituted compliance under Part 9 of NI 94-102.
- 1.11 Pursuant to the Interim Exemption Order, Ontario-resident Schedule I Banks are eligible to access the facilities of JSCC through a Clearing Participant that is a resident outside of Ontario. However, JSCC anticipates that banks, pension plans, asset managers, insurance companies and other entities that have a head office or principal place of business in Ontario may be interested in using JSCC’s customer clearing services in respect of certain OTC IRS derivatives as Ontario Customers. Additionally, JSCC may in the future admit eligible Ontario-resident entities as Clearing Participants. This application is submitted to replace the Interim Exemption Order and in order to permit Ontario Customers to access JSCC’s customer clearing services and to permit JSCC to admit eligible Ontario-resident entities as Clearing Participants; provided that, prior to first admitting a Clearing Participant that is an Ontario-resident entity, JSCC shall obtain a legal opinion that confirms the closeout netting and collateral enforcement provisions of the IRS Business Rules are effective in respect of such proposed Ontario-resident Clearing Participant under applicable laws of Ontario and the federal laws of Canada applicable therein.

2. Ownership, Corporate Structure and Governance Structure

Ownership

- 2.1 JSCC is a majority-owned subsidiary of Japan Exchange Group, Inc. (“**JPX**”). JPX’s other subsidiaries include TSE, OSE, TOCOM, JPX Market Innovation & Research and Japan Exchange Regulation. There are four classes of equity securities in the capital of JSCC: Class A shares, Class B shares, Class C shares and Class D shares. Each share class relates to a different Clearing Business. The Class C shares relate to the IRS Clearing Business. A meeting of the holders of the Class C shares has the right to exercise the powers listed in section 2.4 below. JSCC’s organizational structure is shown in the following chart:

¹ In March 2013, the BOJ formulated the “The Bank of Japan Policy on Oversight of Financial Market Infrastructures,” clarifying the adoption of the PFMI as criteria to be used for evaluating the safety and efficiency of systemically important financial market infrastructures.



2.2 Further information concerning JPX and its activities is available at <https://www.jpex.co.jp/english/>.

General Meeting of Shareholders

2.3 Under the Companies Act, resolutions of a general shareholder meeting include the following:

- matters related to the organization of the company, such as the appointment and dismissal of Directors and Statutory Auditors;
- matters related to the foundation and organization of the company (e.g., amendments to the Articles of Incorporation of JSCC, mergers, and dissolutions);
- matters relating to the important interests of shareholders (e.g., consolidation of shares, dividends of retained earnings, etc.); and
- matters that may be challenging for Directors to resolve (e.g. remuneration of directors).

Class-Shareholders Meeting

2.4 Matters requiring resolution of a general meeting of Class C shareholders include the following:

- a. distribution of any surplus related to the IRS Clearing Business;
- b. modification of the Class C share terms;
- c. reduction of reserves;
- d. merger, company split, or share exchange in consideration of the delivery of Class C shares;
- e. issuance of Class C shares;
- f. issuance of share options to acquire Class C shares;
- g. acquisition of Class C shares by JSCC;
- h. consolidation or split of Class C shares;
- i. change in the number of Directors who may be elected at a general meeting of Class C shareholders; and

j. amendment to Paragraph 5 of Article 21 of the Articles of Incorporation².

Meetings of the holders of the Class A shares and the holders of Class B shares, respectively, have the right to make resolutions with respect to the distribution of any surplus related to the applicable Clearing Business of such classes of shares.

A meeting of the holders of the Class D shares has the right to make resolutions as to the same matters as a meeting of the holders of the Class C shares, in relation to the JGB OTC Transaction Clearing Business.

In addition, the general meeting of holders of Class A, B, C and D shares together may appoint not more than eleven Directors. Additionally, class meetings of the holders of Class B, C and D shares may each appoint one Director.

Board of Directors

- 2.5 JSCC’s Board of Directors (the “**Board**”) is responsible for, among other things, approving high-level policies, strategies and objectives of JSCC, including JSCC’s medium-term business plan, and budgets and investment proposals, and supervising the directors’ execution of their duties. JSCC executes its business plans based on resolutions of the Board. JSCC’s Board bears ultimate responsibility for risk management in line with the Corporate Philosophy. The Board is required to comply with applicable laws and regulations. The Board is subject to review by the Statutory Auditors (as defined below) and at the annual general meeting of shareholders. If the Statutory Auditors find that Directors have engaged in misconduct, are likely to engage in misconduct, or identify violations of laws and regulations or the Articles of Incorporation, or grossly improper activity, the Statutory Auditors shall report the findings to the Board of Directors without delay. In the event of the receipt of a report from a Director to the effect that he/she found a fact that threatens to cause significant damage to JSCC, and in the event of the receipt of a report from an accounting auditor to the effect that he/she found evidence of misconduct relating to the performance of duties of a director, or a material fact in violation of the laws and regulations or the Articles of Incorporation, the Board of Statutory Auditors shall conduct an investigation as necessary and take appropriate measures, such as giving advice or recommendation to the Directors, depending on the situation. Shareholders have the power to appoint and dismiss Directors. JSCC’s Governance Guidelines set out in more detail the roles and responsibilities of the Board of Directors, and are available at: <https://www.jpx.co.jp/jscc/en/risk/governance.html>.
- 2.6 The Board is composed of two full-time directors and five part-time directors. The members of the Board are elected for a term of two years. The directors are required to be selected on the basis that they have the knowledge and experience to carry out the business and affairs of JSCC appropriately and securely, and are of sufficiently good repute.
- 2.7 At the time of this submission, the following individuals are serving as Board members:

The JSCC Board of Directors

Name	Current Primary Position
Konuma Yasuyuki	President & CEO ¹
Isomoto Naoki	Executive Officer ¹
Asai Kunihiko	Senior Corporate Managing Director, Nikko Asset Management CO., Ltd. ²
Ohashi Kazuhiko	Professor, Graduate School of Business Administration, Hitotsubashi University ³
Kato Izuru	President, Representative Director, Chief Economist of Totan Research CO., Ltd. ²
Sakata Hideki	Senior Managing Director, Global Markets, Nomura Securities CO., Ltd. ²
Sasaki Daishi	Co-Head of Global Markets Company (in charge of Fixed Income, Foreign Exchange and Equities), Mizuho Financial Group, Inc. ²
Futagi Satoshi	Senior Executive Officer, Japan Exchange Group, Inc.

² Paragraphs 4 and 5 of Article 21 (Board of Directors) of JSCC’s Articles of Incorporation are as follows:
 4. A Resolution of the Board of Directors shall be adopted at its meeting at which a majority of the Directors entitled to participate in the resolution shall be present and by a majority of the Directors so present.
 5. Notwithstanding the provision of the immediately preceding Paragraph, when the Board of Directors re-consults with the IRS Management Committee as prescribed in the Interest Rate Swap Clearing Business Rules any resolution made by such Committee and such Committee re-passes its resolution in response to such re-consultation and then the Board of Directors passes its resolution contrary to such re-resolution by such Committee, such resolution of the Board of Directors shall be adopted at the meeting at which a majority of the Directors entitled to participate in the resolution shall be present and by not less than two-thirds (2/3) of the Directors so present.

Notes:

1. Full-time director.
2. Independent of JPX and JSCC.
3. Independent of Clearing Participants, their affiliates, JPX and JSCC.

Advisory Committees

2.8 The Board has established committees to advise on matters considered necessary to fulfill its supervisory responsibilities (“**Advisory Committees**”). The Advisory Committees consist of two Committees that are common to all Clearing Businesses, the Risk Committee and the Disciplinary Measures Assessment Committee, and certain committees that each relate to a specific Clearing Business and function to incorporate the opinions of Clearing Participants into JSCC’s governance. The following Advisory Committees advise in respect of the IRS Clearing Business:

- (1) Risk Committee: Where the Board intends to make a decision on a matter considered necessary to perform its duties related to risks of the Clearing Businesses, it must seek the advice of the Risk Committee. The Risk Committee is selected by the Board and is composed of individuals who are external directors of JSCC, officers of Clearing Participants or their customers, or are otherwise considered qualified.
- (2) Disciplinary Measures Assessment Committee: For matters involving actions against Clearing Participants, JSCC consults with the Disciplinary Measures Assessment Committee, which is composed of individuals who are independent from JSCC and are selected by the Board from among persons who have deep insight concerning the matters for consultation and the ability to exercise fair judgment. The Disciplinary Measures Assessment Committee Rules provide that a committee member with a special interest in a matter being deliberated at the Disciplinary Measures Assessment Committee may not participate in that deliberation.
- (3) IRS Management Committee: This committee discusses matters for consultation set forth in the IRS Business Rules and IRS Management Committee Rules. Members are appointed by the Board from among the officers and employees of IRS Clearing Participants and the Class C shareholders.
- (4) IRS Default Management Committee: This committee advises on matters such as hedging when the default of an IRS Clearing Participant is determined and bidding during default auctions. Members are selected by the Board from the officers and employees of IRS Clearing Participants.

Statutory Auditors

2.9 JSCC maintains a Board of Statutory Auditors, as required by the Companies Act (the “**Statutory Auditors**”). The duties of the Statutory Auditors are defined in the Companies Act, and include preparing audit reports, appointing and removing full-time statutory auditors, deciding audit policy, deciding the method to investigate the status of business and assets of the company, and other matters related to the execution of the auditor’s duties. Audit reports cover matters prescribed by the Companies Act, including the accuracy JSCC’s annual business report and annual financial statements (and other documents prescribed by statute), and are presented to the general meeting of shareholders annually. JSCC’s annual business reports include comprehensive descriptions relating to its business, including in respect of information technology systems. The Statutory Auditors have authority under the Companies Act to investigate company business and assets, to request a meeting of the Board, and to report on the improper conduct of a director. The Statutory Auditors have the obligation and responsibility to report results of audits to shareholders, and to ensure, and to keep the shareholders informed regarding, the lawfulness of directors’ activities. Each Statutory Auditor is nominated for election by the Board of Directors, subject to the absence of objection by the Board of Statutory Auditors, and must be elected by a resolution of the general meeting of shareholders.

2.10 At the time of this submission, the following individuals are serving as Statutory Auditors:

The JSCC Board of Statutory Auditors

Name	Current Primary Position
Suzuki Yoshihiko	Standing Statutory Auditor
Morishita Kunihiko	Attorney-at-law
Yanaga Masao	Professor, Graduate School of Professional Accountancy, Meiji University

3. Regulatory Framework

Domestic Regulatory framework

- 3.1 JSCC holds a license to conduct the “Financial Instruments Obligation Assumption Service” under the FIEA, which permits it to conduct the business of clearing financial instruments as a CCP. JSCC also holds a license for conducting the “Business of Assuming Commodity Transaction Debts” under the CDA, which permits it to conduct the business of clearing transactions in commodities and commodity derivatives. JSCC’s business is governed by the FIEA, CDA and other Japanese laws. JSCC has established Business Rules for each of its Clearing Businesses, which are subject to approval by the Prime Minister of Japan (except in the case of the Business Rules on Business of Assuming Commodity Transaction Debts, which are subject to the approval of the Minister of the MAFF and the Minister of the METI). JSCC is obligated by the FIEA and CDA to conduct its business and operations according to the Business Rules, thus making these rules (including the IRS Business Rules) legally binding and enforceable. As noted above, JSCC is subject to the direct regulation and supervision by the JFSA, the MAFF, and the METI, and oversight by the BOJ in accordance with objectives prescribed in the *Bank of Japan Act*.
- 3.2 The following table shows the domestic legal and regulatory framework for JSCC, with a box highlighting matters relevant to the IRS Clearing Business:

Clearing Business	Product	Market	Law	Supervisory Authority
Listed Products	Cash Products	Japanese Securities Exchanges, PTS	FIEA	JFSA
	Listed Financial Derivatives	OSE		
	Listed Commodity Derivatives	TOCOM	CDA	METI
		ODEX		MAFF
CDS	CDS			
IRS	IRS	OTC	FIEA	JFSA
OTC JGB	OTC JGB			

Overseas Regulatory Framework

- 3.3 JSCC has obtained recognition as a Third Country CCP under the European Market Infrastructure Regulation (“EMIR”) from the EU’s European Securities and Markets Authority (“ESMA”) to provide all its clearing services to Clearing Participants established in European Union (“EU”) countries. Currently, some of JSCC’s Clearing Participants are domiciled in EU countries.
- 3.4 In Australia, JSCC has received a designation as a “prescribed facility” under the *Corporations Amendment (Central Clearing and Single-Sided Reporting) Regulation 2015*. Although JSCC does not currently have any Australian domiciled IRS Clearing Participants, this designation would permit JSCC to admit an Australian IRS Clearing Participant.
- 3.5 Some affiliates of Clearing Participants that clear CDS or IRS through JSCC are categorized as U.S. Persons under the guidelines of the U.S. Commodity Futures Trading Commission (“CFTC”). To allow these trading entities to access JSCC’s Clearing Businesses for swaps (as defined in the CFTC’s rules), JSCC has obtained from the CFTC an order of exemption from registration as a Derivatives Clearing Organization under the U.S. *Commodity Exchange Act*.
- 3.6 JSCC has obtained from the Hong Kong Securities and Futures Commission (“SFC”) authorization to provide Automated Trading Services, as well as designation as a central counterparty, which can be used for the observance of mandatory clearing obligations under the Securities and Futures Ordinance (“SFO”). Currently, one IRS Clearing Participant is incorporated in Hong Kong.

B.11: CIRO, Marketplaces, Clearing Agencies and Trade Repositories

- 3.7 JSCC has obtained recognition as a Foreign Central Counterparty under the Financial Market Infrastructure Act from the Swiss Financial Market Supervisory Authority (“FINMA”) to offer IRS Clearing Services. Currently, one IRS Clearing Participant is incorporated in Switzerland.
- 3.8 JSCC has obtained temporary recognition from the Bank of England for the provision of all its clearing services in the U.K. as a Third Country CCP under the *Central Counterparties (Amendment, etc., and Transitional Provision) (EU Exit) Regulations 2018*, to provide services to Clearing Participants and trading facilities established in the U.K. Some of JSCC’s Clearing Participants are incorporated in the U.K.
- 3.9 As a result of the various authorizations described in the foregoing paragraphs, applicable trading entities in the referenced jurisdictions may satisfy certain obligations in relation to the central clearing requirements of OTC derivative transactions that are in effect in the EU, Australia, the U.S., Hong Kong, Switzerland, and the U.K., as applicable, by clearing such trades through JSCC.
- 3.10 To provide trading participants established in the U.S. with direct access to the trading systems for Listed Derivatives listed on OSE and TOCOM, each of OSE and TOCOM maintains a registration with the CFTC as a Foreign Board of Trade under the U.S. *Commodity Exchange Act*. Each such registration includes a designation of JSCC as a CCP for the clearing of trades executed at OSE and TOCOM, respectively.
- 3.11 The following table summarizes JSCC’s various authorizations, recognitions, designations, and exemptions from overseas regulatory authorities:

Country / Region	Covered Trades	Relevant Authority	Authorization, Recognition, Designation, Exemption Obtained
EU	All Cleared Trades	ESMA	Recognition as a Third Country CCP under EMIR
Australia	IRS	Australian Securities and Investments Commission and Reserve Bank of Australia	Designation as a “prescribed facility” under Corporations Amendment (Central Clearing and Single-Sided Reporting) Regulation 2015
US	CDS IRS	CFTC	Order of exemption from Registration as a Derivatives Clearing Organization under the Commodity Exchange Act
Hong Kong	IRS	SFC	Authorization to Provide Automated Trading Services, and Designation as a Central Counterparty, that can be Used for the Observance of Mandatory Clearing Obligations, under SFO
Switzerland	IRS	FINMA	Recognition as Foreign Central Counterparty under Financial Market Infrastructure Act
UK	All Cleared Trades	Bank of England	Temporary Recognition as a Third Country CCP under The Central Counterparties (Amendment, etc., and Transitional Provision) (EU Exit) Regulations 2018

4. Clearing Participants of JSCC

- 4.1 JSCC defines qualifications for clearing participants separately for each Clearing Business. This is done to manage the credit risk of participants, with the criteria for each clearing participant category aligned with the nature of the applicable Clearing Business. Criteria for participation are designed to be reasonable, clear, and publicly available, focusing primarily on the entity’s management structure, financial conditions, and business capability. JSCC continually monitors each Clearing Participant’s management structure, financial condition, and business execution capability. If JSCC recognizes a problematic situation, it has the discretion to initiate a process to suspend clearing services in whole or in part for that Clearing Participant, or revoke its clearing qualification, as necessary. The process includes in-advance hearing opportunities for the affected Clearing Participant and is subject to the assessment and advice by Disciplinary Measures Assessment Committee under the Disciplinary Measures Assessment Committee Rules.

- 4.2 As of the end of January 2024, there were a total of 124 clearing participants for Cash Products and Listed Derivatives, 11 CDS clearing participants, 26 IRS Clearing Participants, and 41 OTC JGB clearing participants.³
- 4.3 In respect of the IRS Clearing Business, a Clearing Participant is a person that holds an IRS Clearing Qualification, allowing it to become JSCC's counterparty in a cleared IRS Transaction in accordance with the IRS Business Rules. There are no other participant types or sub-categories of Clearing Participant in respect of the IRS Clearing Business.
- 4.4 To acquire and maintain its Clearing Qualification related to IRS Transactions, each Clearing Participant must meet criteria prescribed by JSCC and set out in the IRS Business Rules. These include that the Clearing Participant must:
- (1) be licensed as a "Financial Instruments Business Operator" under the FIEA or a "Registered Financial Institution" under the FIEA;
 - (2) satisfy certain criteria with respect to financial conditions; and
 - (3) have a sound management structure and appropriate business execution structure as a Clearing Participant.
- 4.5 The Clearing Participant criteria apply uniformly to all applicants, and all Clearing Participants for IRS have access to the same range of accounts and services as described in the IRS Business Rules.
- 4.6 Further information on such criteria is available in the IRS Business Rules and JSCC's "Guideline on Standard for Clearing Qualification Acquisition in Credit Default Swap and Interest Rate Swap Clearing" available at: https://www.jpjx.co.jp/jscjcc/en/rule/rule_irs.html.
- 4.7 Each Clearing Participant must enter into a Clearing Participant Agreement with JSCC, pursuant to which it agrees to comply with JSCC's Business Rules. Only Clearing Participants can set up accounts with JSCC and access the system for clearing services. By comparison, clients of Clearing Participants in respect of clearing services for IRS must: (i) enter into a clearing brokerage agreement with a clearing broker that is a Clearing Participant in accordance with the format prescribed by IRS Business Rules, and (ii) submit to JSCC a letter of undertaking requiring them to comply with the IRS Business Rules. Onboarded clients access JSCC's IRS clearing services through their broker Clearing Participant's customer accounts.
- 5. IRS Clearing Procedures and System Design**
- 5.1 JSCC opens an account for each Clearing Participant ("**Clearing Participant Account**") to manage initial margin and variation margin in respect of each cleared IRS Transaction to which a Clearing Participant is a party, and other Funds to be paid or received in respect of such transactions. Each cleared IRS Transaction of a Clearing Participant is recorded in its Clearing Participant Account.
- 5.2 The clearing of OTC IRS transactions is conducted on each business day during the periods from 09:00 to 12:00, 13:00 to 16:00, and 17:30 to 19:00 (JST). Any requests for clearing an OTC IRS transaction received by JSCC outside of these periods are processed at the beginning of the next such period (e.g., a request received at 16:01 is processed at or about 17:30). Cleared IRS transactions include transactions executed through Electronic Trading Platforms provided by institutions registered with the JFSA, SEFs (Swap Execution Facilities) registered with the CFTC, or MTFs (Multilateral Trading Facilities) or OTFs (Organised Trading Facilities) operating in the EU under the Markets in Financial Instruments Directive (MiFID) and the Markets in Financial Instruments Regulation (MiFIR).
- 5.3 Upon receipt of an application to clear a new eligible IRS Transaction, or multiple such transactions (referred to collectively as a "**Package Trade**"), from a Clearing Participant, JSCC calculates the amount of variation margin and initial margin required to cover the entire portfolio of the Clearing Participant, including both the new transaction(s) and all existing cleared transactions. If the Clearing Participant's deposited collateral is at least equal to the required amount, JSCC would clear the new trade.⁴
- 5.4 JSCC outsources the development and operation of its IT systems to TSE, a JPX subsidiary and JSCC affiliate. JSCC manages outsourcing arrangements according to clearly defined outsourcing guidelines and criteria. The guidelines provide detailed criteria that third parties must meet to be eligible to provide outsourced services to JSCC, and prescribe the internal process JSCC must follow before outsourcing, including completing a prescribed checklist in respect of the eligibility criteria and other matters, which is required to be confirmed as between JSCC and potential system vendors,

³ See the JSCC website at <https://www.jpjx.co.jp/jscjcc/en/participant.html> for lists of all JSCC Clearing Participants.

⁴ JSCC can accept clearing applications even if a sufficient amount of margin is not deposited with JSCC at the time of clearing application for the applicable Clearing Participant or customer, if certain prescribed conditions are met (including the shortfall being below a prescribed aggregate cap), in order to reduce the number of rejections of applications in circumstances where the Clearing Participant or customer is temporarily unable to deposit sufficient collateral for operational reasons. This rule became effective on March 4, 2024, and more detailed information is available at: https://www.jpjx.co.jp/jscjcc/en/cimhll00000001ri-att/Public_Comment_e_202311102.pdf

and must then be assessed by independent departments within JSCC. The guidelines also provide the format of contract to be entered into with the IT system vendors, which prescribes obligations of the vendors related to the system securities.

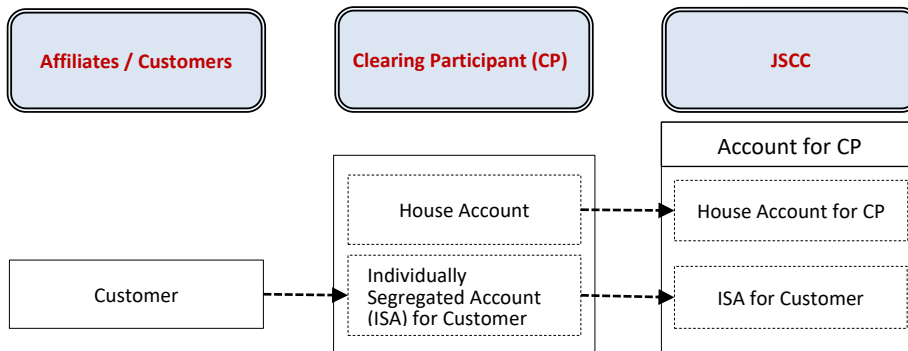
5.5 The table below sets out a list of IRS Transactions eligible for clearing through JSCC. Details of the eligible transaction types are also available at <https://www.jpx.co.jp/jsccl/en/cash/irs/product.html>.

IRS Fix-Float	
1	JPY-TONA-OIS-COMPOUND or JPY-TONA-OIS-Compound ("OIS")
2	JPY-TIBOR-ZTIBOR or JPY-Euroyen TIBOR ("Z TIBOR") (1M,3M,6M)
3	JPY-TIBOR-17097 or JPY-TIBOR ("D TIBOR") (1M,3M,6M)
Basis Swap-Tenor Swap (JPY)	
4	Z TIBOR (1M,3M,6M)
5	D TIBOR (1M,3M,6M)
6	OIS
Basis Swap-Curve Swap	
7	OIS vs Z TIBOR
8	OIS vs D TIBOR
9	Z TIBOR vs D TIBOR

6. Customer Protection in JSCC’s IRS Clearing Business

Segregated Management of Customer Positions and Margin

6.1 For IRS Transactions, JSCC segregates each Clearing Participant’s proprietary positions and margin from the positions and margin of each customer of the Clearing Participant. Specifically, the positions and margin of each customer are segregated in individual customer accounts with JSCC at all times, regardless of whether or not the customer is an affiliate of the Clearing Participant. JSCC has established this framework to protect margin related to the positions of each customer from the default or insolvency of a Clearing Participant. The figure below outlines JSCC’s customer account structure:



6.2 JSCC has adopted optional position transfer arrangements for customer protection. To complete such a transfer, the customer must have in place a prior agreement for this purpose with the Clearing Participant receiving the transfer. The customer must apply to JSCC via the Clearing Participant receiving the transfer, upon which the transferee Clearing Participant accepts the transfer. JSCC would confirm that the required amount of margin pertaining to the transferring positions has been deposited in the customer account at such Clearing Participant. Upon such confirmation, JSCC completes the transfer. By using this option, if a customer’s Clearing Participant defaults, the customer may transfer its own positions and margin to a surviving Clearing Participant, and thereby avoid those positions being liquidated under the default management process.

- 6.3 In addition, customers of any Clearing Participant have an option of pre-arranging a back-up Clearing Participant such that if the customer's Clearing Participant defaults, the customer may immediately transfer its own positions and margin to the back-up Clearing Participant subject to the acceptance of the back-up broker.
- 6.4 Entities clearing through Clearing Participants (whether affiliates or customers of Clearing Participants) have the right to claim payment from JSCC as to the "profit equivalent" which they should have received on and after the default determination date, when they choose not to transfer their positions to another Clearing Participant following a Clearing Participant default, and they also have the right to claim the return of Initial Margin directly from JSCC, less the amount of mark-to-market loss pertaining to their own positions.

Protection from Fellow Customer Risk

- 6.5 JSCC has adopted arrangements to protect customers from the risk of default by another customer of the same Clearing Participant.
- 6.6 For the IRS Clearing Businesses, customer margin is individually segregated in accounts for each customer at JSCC. Clearing Participants must deposit the full amount of customer margin with JSCC without delay when they receive margin from a customer. The IRS Business Rules do not allow for the netting of positions recorded in different customer accounts.

Legal Basis for Customer Protection

- 6.7 Japanese law stipulates that in the event of a Clearing Participant default, JSCC's Business Rules would be applied in preference to the general *Bankruptcy Act* (Japan), for the management of outstanding positions between the defaulting Clearing Participant and JSCC.⁵ Therefore, JSCC has the legal authority to liquidate the proprietary positions of a defaulting Clearing Participant and to transfer or liquidate the customer positions of a defaulting Clearing Participant, as stipulated in JSCC's Business Rules.
- 6.8 JSCC uses a trust scheme for the collateral posted by Clearing Participants and their customers. The trust assets are legally protected from the risk of the trustee's default under Japanese law. Also, it allows collateral to be isolated from the default risk of JSCC. In the event of JSCC going bankrupt, the trust bank would return customer collateral directly to each customer, in accordance with payment instructions provided by an independent attorney at law. The attorney is appointed in advance as part of the arrangement and acts as an agent for all of the customers.
- 6.9 Alternatively, a customer and a Clearing Participant can agree to use JSCC's account with the Bank of Japan for the custody of cash collateral instead of using such trust arrangements. By electing to use the model in which cash collateral is held in JSCC's account at the Bank of Japan, clients are insulated from any fellow customer risk and risk associated with a defaulting Clearing Participant.

7. Overview on JSCC Margining, the IRS Clearing Fund and the Default Waterfall

Margin Methodology

- 7.1 JSCC uses different margin frameworks for each of the product types it clears, being Listed Cash Products, Listed Derivatives, CDS, IRS and OTC JGB.
- 7.2 JSCC requires variation margin and initial margin to be deposited by all Clearing Participants, according to the nature of the products in each Clearing Business. For derivatives transactions, including IRS, JSCC also requires the deposit of variation margin and initial margin from customers. Variation margin and initial margin, which cover current exposure and potential future exposure, are to provide coverage for the depositor's own potential losses, and the required amount of each is determined according to positions and market fluctuations.
- 7.3 Additionally, when accepting new IRS transactions from Clearing Participants, JSCC requires the posting of collateral that would be required to cover the entire portfolio, including both the new transaction (or all new transactions in the case of a Package Trade) and all existing cleared transactions, before clearing the new transaction. New trades which fail to fulfill this requirement are rejected.⁶
- 7.4 When customers' deposit of initial margin with a Clearing Participant is operationally difficult, for instance when transactions by customers in a different time zone are expected, and there is prior agreement between the Clearing Participant and the customer for this purpose, JSCC permits customers to deposit initial margin with a Clearing Participant by the business day following that on which the Clearing Participant deposited initial margin for such customer transactions with JSCC.

⁵ See FIEA, Article 156-11-2.

⁶ See footnote 4 above.

Initial Margin for IRS

7.5 JSCC calculates the required amount of initial margin for IRS transactions using a historical simulation (expected shortfall) methodology, and adding the amount determined in consideration of the liquidity risk of IRS transactions.

Initial Margin

- (1) The required amount of initial margin is calculated using a historical simulation (expected shortfall) methodology to cover risks from interest rate fluctuations. Specifically, it is set to cover a certain amount of a Net Present Value fluctuation calculated using a daily yield curve fluctuation scenario for a given historical period.
- (2) Parameters used in the calculation include a reference period of 1,250 days, a confidence level of the average of the worst 1%, and a holding period of 5 days (7 days for customer transactions). In addition to the reference period, data from significant historical interest rate fluctuations are also used as stress scenarios. This is to prevent sudden changes in required initial margin when stress events are applied to, or removed from, the interest rate fluctuations during the reference period.
- (3) Additionally, JSCC has methodologies in place (Volatility Scaling methodology based in Exponentially Weighted Moving Average method) to revise the historical interest rate fluctuation scenarios, based on the latest interest rate environment, in order to reflect the current interest rate environment promptly.
- (4) JSCC provides a cross margining service (the “**Cross Margining Service**”), enabling the risk offset between 1) JPY-denominated IRS and 2) certain Japanese Government Bond futures contracts (“**JGB Futures**”) and/or certain Japanese interest rate futures contracts (“**Interest Rate Futures**”), to Clearing Participants, Affiliates, and non-Affiliated customers of the IRS Clearing Business, for whom the Notification of Using Cross Margining has been submitted to JSCC. JSCC calculates the required initial margin for them by using the same historical simulation (expected shortfall) methodology as the IRS Clearing Business.

Liquidity Charge

- (5) Liquidity Charge is calculated to cover market liquidity risk arising from the liquidation of a defaulting Clearing Participant’s positions. The Liquidity Charge is calculated by multiplying a position sensitivity (PV01) by a bid/ask spread derived from a market survey of Clearing Participants, and then reflecting a correlation coefficient based on past interest rate fluctuations between tenor buckets.

Variation Margin / Intraday Margin for IRS

7.6 JSCC has adopted variation margin frameworks that aim to reduce current exposure. Variation margin is generally paid/received once per day. When calculating variation margin, positions are marked-to-market using the most recent market prices, and the difference between the prior valuation and the latest mark-to-market is paid/received.⁷ To be specific, variation margin is an amount to cover variation of the value of positions calculated using yield curves as of 15:02 (Japan time) from the value of positions calculated using yield curves as of 15:02 on previous business day with respect to positions of each IRS Clearing Participant as of 16:00. Quotes as of 15:02 are obtained from information vendors and inter-dealer brokers with respect to grid points prescribed by JSCC. JSCC calculates the average of such quotes after discarding the highest and the lowest (in principle) and the yield curves are generated based on such averages.

7.7 JSCC recalculates the margin requirements at noon based on the most recent positions of each Clearing Participant, and may issue intraday margin calls, if required, to cover any intraday shortfall. Moreover, a framework is also in place to handle large price fluctuations, under which additional margin calculations are made, and JSCC may issue additional intraday margin calls, if required.

Cross Margining Service

7.8 JSCC’s Cross Margining Service provides Clearing Participants and customers that use both the 1) IRS and 2) JGB Futures and/or Interest Rate Futures clearing services of JSCC with the option to elect to cross margin 1) IRS and 2) JGB Futures and/or Interest Rate Futures positions. Upon making such election, the required amount of initial margin for the Clearing Participant or the customer (each a “**CMS User**”), as applicable, is calculated on a portfolio basis across IRS, JGB Futures and Interest Rate Futures. If the CMS User or its intermediary defaults, then, pursuant to JSCC’s Business Rules, the relevant JGB Futures and Interest Rate Futures positions of the CMS User would be automatically transferred to the CMS User’s IRS account (which, for the avoidance of doubt, can be used to hold JGB Futures and Interest Rate Futures positions), so that the default losses of the CMS User with respect to IRS, JGB Futures and Interest Rate Futures are netted in a single account. Although intermediaries can use omnibus accounts for customers with

⁷ Clearing Participants, Affiliates, and non-Affiliated customers of the IRS Clearing Business can select payment and receipt of mark-to-market difference, according to the daily fund settlement, in lieu of payment and receipt of variation margin (Variation-Margin-as-Settlement).

respect to JGB Futures and Interest Rate Futures, when a CMS User or its intermediary defaults, the outstanding positions of IRS, JGB Futures and Interest Rate Futures for such entity are aggregated in the entity's Individually Segregated Account for IRS (rather than the omnibus account for JGB Futures and Interest Rate Futures). Accordingly, there is no fellow customer risk with respect to IRS positions held by CMS Users even if they use the Cross Margining Service.

- 7.9 Margin calls for CMS Users are made with respect to the relevant IRS account on a portfolio basis. Once the CMS User fulfills such a call at the relevant IRS account, the margin requirement (calculated on a portfolio basis), the Cross Margining Service for such CMS User becomes effective. The CMS User's participation in the Cross Margining Service will be subject to the CMS User's fulfillment of its margin obligations based on the amount calculated using cross-margining.
- 7.10 If and when a CMS User or its intermediary defaults, the relevant JGB Futures and Interest Rate Futures positions of the CMS User are transferred to the relevant IRS account, so that the profits and losses of both portfolios are netted, and the losses (if any) are covered by the IRS initial margin calculated on a portfolio basis and deposited at the IRS account. For the avoidance of doubt, the only margin held in respect of the applicable IRS, JGB Futures and Interest Rate Futures positions that are cross-margined is held in the IRS account. No margin would be held in a relevant JGB Futures account or Interest Rate Futures account, since the relevant JGB Futures and Interest Rate Futures positions will be transferred to the IRS account if a default occurs.

Backtesting

- 7.11 JSCC conducts daily backtesting to assess the robustness of its margin model. Parameters used to calculate required margin are regularly revised, with additional revisions made for times of market stress. JSCC also updates historical data on price fluctuations for margin calculation of IRS transactions on a daily basis. As such, correlated fluctuations are reflected in margin calculations in a timely manner.
- 7.12 JSCC's backtesting in part involves comparing the margin requirement for each account and the actual losses arising from positions in the account (i.e., the losses based on actual market fluctuations on and after the base date) on a daily basis, to confirm that the target confidence level prescribed in JSCC's Risk Management Policy is achieved. Additionally, JSCC performs backtesting to compare the margin requirement for each account and the hypothetical loss which may arise from positions in the account (calculated assuming that the position on the base date existed before the base date), using statistical analysis. If the target confidence level has not been achieved, JSCC would analyze the cause, and examine appropriate measures, such as revisions to the margin model or parameters, as needed.
- 7.13 JSCC reports backtesting results to JSCC's Risk Oversight Committee on a monthly basis, to the Board of Directors on a quarterly basis, and to Clearing Participants via the advisory committees of each Clearing Business on an annual basis.
- 7.14 JSCC has an internal Risk Management Division that is independent from each Clearing Business division. The Risk Management Division reviews and validates its overall margining models at least annually. Within these reviews, JSCC evaluates the policies and calculation methods of the risk management framework, including margining, and validates their sufficiency and propriety based on backtesting and stress testing results. The results of the overall review and validation of the margin model are presented annually to the Board of Directors and to Clearing Participants via the advisory committees of each Clearing Business.

IRS Clearing Fund

- 7.15 JSCC requires each Clearing Participant to contribute to a clearing fund which covers potential future exposure in the case of the default of multiple Clearing Participants in extreme but plausible market conditions. For the IRS Clearing Business, default expectations are set to the two largest Clearing Participants, including any other Clearing Participant that is an "affiliate" (as defined in the PFMI) of the Clearing Participant. The required amount for the IRS Clearing Fund is revised on a daily basis.
- 7.16 On each business day, the portion of the amount of potential loss that could arise under market conditions considered by JSCC to be extreme but plausible exceeding the amount of Initial Margin (i.e., the excess risk amount) is calculated with respect to the positions of each IRS Clearing Participant as of 19:00 on such day. The amount required to be deposited to the IRS Clearing Fund is the amount equivalent to the expected loss arising at the time of the simultaneous default of two IRS Clearing Participants whose excess risk amounts are the largest and the second largest, prorated according to the Required Initial Margin amount of each IRS Clearing Participant (after any increase). If such amount is less than 100 million yen, then the Clearing Participant must deposit 100 million yen.
- 7.17 Stress scenarios are set by using Principal Component Analysis and historical scenarios. The expected losses that could arise on the part of each Clearing Participant (the risk equivalent under stressed conditions) is calculated with respect to these stress scenarios.

Stress Testing

- 7.18 JSCC conducts stress testing at least daily to determine whether pre-funded loss compensation financial resources, including margin, clearing fund, and JSCC's contribution, are sufficient to cover potential losses, as well as whether the total loss compensation resources, comprised of the aforementioned pre-funded resources plus additional contributions from Clearing Participants, are sufficient to cover the potential losses.
- 7.19 JSCC's stress testing framework considers the largest historical movements in a range of stress events and extreme but plausible hypothetical scenarios.
- 7.20 The results of daily stress testing are reported to the Chief Risk Officer ("**CRO**"), CEO, other full-time directors, and the related division head. Additionally, stress testing results are reported as a part of a status report of compliance with JSCC's Risk Management Policy as it pertains to credit risk to the Risk Oversight Committee on a monthly basis, and to the Board of Directors on a quarterly basis. The results are also reported monthly to Clearing Participants in the "Risk Profile Report" and annually to the advisory committee for each Clearing Business, whose members include Clearing Participants. If a problem with the sufficiency of the loss compensation resources is identified during stress testing, JSCC would maintain the sufficiency of the pre-funded loss compensation resources by recalculating the size of the clearing fund, or by making an additional initial margin call. JSCC would also consider taking other appropriate actions. For example, JSCC would identify the cause of any insufficiency and, if necessary, undertake remedial measures, including revising the existing financial resource framework through rule amendments and capital improvements.
- 7.21 In accordance with the Risk Management Policy, JSCC validates the suitability of the scenarios, models, and parameters used in stress testing of loss compensation resources on at least a monthly basis. JSCC's stress scenarios reflect recent market prices, volatility fluctuations, and positions. For market liquidity fluctuations, rules for securing resources are prepared according to necessity for each clearing service and parameters are revised based on prevailing market conditions. JSCC also conducts daily reverse stress testing to identify excessively extreme scenarios where the loss compensation financial resources would become insufficient.
- 7.22 In accordance with the Risk Management Policy, JSCC's Risk Management Division validates the overall risk management model at least annually, making recommendations regarding revisions to the relevant Clearing Business division, as necessary. The reporting line of the Risk Management Division is independent from each Clearing Business division, reporting directly to the CRO. This helps keep the validation process conducted by the Risk Management Division independent from the Clearing Business divisions. The validation process verifies the effectiveness of the margin and clearing fund model and calculations, and makes recommendations regarding revisions as necessary. The results of the validations are reported to the Board of Directors and the advisory committees of each Clearing Business (i.e., the Listed Products Management Committee, CDS Management Committee, IRS Management Committee, and OTC JGB Management Committee).

Default Management Procedures and Default Waterfall

- 7.23 JSCC's IRS Business Rules set out the details of the default management procedures, including the events constituting a default, the sequencing of the process and obligations of parties involved. JSCC would declare that a Clearing Participant is in default if JSCC's senior management determines that such participant is, or is likely to be, unable to perform its obligations. If a default is declared, JSCC can take actions to contain losses by halting clearing of new transactions from the defaulter and liquidating the defaulter's positions.
- 7.24 JSCC's methods for disposing of positions vary according to the nature of the product for each Clearing Business. Specifically for JSCC's IRS Clearing Business, an auction involving non-defaulting Clearing Participants is used. In addition, hedge transactions may be promptly executed for the defaulter's portfolio to minimize the risk of losses prior to the disposal of the defaulter's positions. For the IRS Clearing Business, hedge transactions are executed based on the advice of the IRS Default Management Committee.
- 7.25 When disposing of Clearing Participant positions, customer positions and collateral can be transferred to non-defaulting Clearing Participants in accordance with the IRS Business Rules. JSCC uses its loss compensation financial resources according to its IRS Business Rules to cover losses arising in the default process.
- 7.26 Even when a Clearing Participant default occurs, JSCC fulfills settlement according to a regular schedule. To fulfill settlement in this manner, JSCC maintains Liquidity Supply Facilities for procuring necessary liquidity.
- 7.27 For the IRS Clearing Business, losses resulting from a Clearing Participant default would be covered in the following order, as set out in Articles 101 to 111 of the IRS Business Rules:

Contribution from the Defaulting Participant

- (1) The defaulting Clearing Participant's "house margin" (initial and variation margin) is consumed.
- (2) The balance of the defaulting Clearing Participant's deposits to the IRS Clearing Fund (including collateral deposited for other Clearing Businesses, if any remains) is consumed.

Contribution from JSCC

- (3) JSCC contributes up to two billion yen of its stockholders' equity as financial resources for loss compensation (the "**First Tier IRS Settlement Guarantee Reserve**").
 - (a) Upon consumption of JSCC's contribution, it would be subject to replenishment. Required actions for replenishment are specified in JSCC's Recovery Plan. Should the replenishment of its capital be difficult, JSCC has an arrangement in place for required financing with JPX, its parent company.

IRS Clearing Fund contributions from non-defaulting Clearing Participants and an additional contribution from JSCC

- (4) The following are consumed on a pro rata basis: (i) IRS Clearing Fund contributions from non-defaulting Clearing Participants, and (ii) an additional contribution up to two billion yen of JSCC's stockholder's equity (together with the First Tier IRS Settlement Guarantee Reserve, "**JSCC Compensation Capital**").
 - (a) IRS Clearing Fund contributions from non-defaulting Clearing Participants are consumed according to the risk amount of each participant.
 - (b) The IRS Clearing Fund contributions from non-defaulting Clearing Participants are capped at a certain level. For further defaults occurring during the Capped Period, such contributions are capped at the required IRS Clearing Fund amount immediately preceding the initial default.
 - (c) The amount of IRS Clearing Fund contribution from non-defaulting Clearing Participants consumed is determined according to the quality of participation in the auction for disposing of the defaulter's positions. The IRS Clearing Fund contributions of Clearing Participants with a lower level of auction participation would be consumed first, and the IRS Clearing Fund contributions of the bid winning Clearing Participant would be consumed after the entire IRS Clearing Fund contribution from all other Clearing Participants are consumed.
 - (d) If a loss consumes all or part of the IRS Clearing Fund contributions from the non-defaulting Clearing Participants, then contributions would be replenished following the end of the Capped Period. To cover credit risk during the Capped Period, JSCC calculates the required IRS Clearing Fund for each non-defaulting Clearing Participant on a daily basis. If the required IRS Clearing Fund exceeds the required IRS Clearing Fund for the day immediately preceding the first default, JSCC would call for the additional amount as Default Contingent Margin. The Default Contingent Margin is a defaulter-pay type collateral to be used as financial resources to cover losses arising from the potential default of the Clearing Participant that deposited the Default Contingent Margin.

Additional contribution from non-defaulting Clearing Participants

- (5) If the loss resulting from a Clearing Participant default exceeds the sum of all the preceding financial resources, an additional contribution called a "Special Clearing Charge" is required from the non-defaulting Clearing Participants. The Special Clearing Charge for defaults occurring during a Capped Period is capped at an amount equal to the required amount of IRS Clearing Fund deposits immediately preceding the first default. This mitigates the procyclical impact on Clearing Participants of the additional contribution.
 - (a) The Special Clearing Charge would be applied according to quality of non-defaulting Clearing Participants' participation in the auction for disposing of the defaulter's positions. The charge would be first applied to Clearing Participants with lower level of auction participation.

Variation Margin Haircutting

- (6) If the loss resulting from a Clearing Participant default exceeds the sum of all the preceding financial resources, all non-defaulting Clearing Participants with positive variation margin from the default date are required to compensate the loss via reductions in such positive Variation Margin ("**Variation Margin Haircutting**"), to a maximum of the relevant variation margin amount.

7.28 If, following the Variation Margin Haircutting step, JSCC considers that the loss compensation financial resources are insufficient to cover the loss, Clearing Participants and JSCC would hold a consultation on the countermeasures for the settlement of the loss. If an agreement cannot be reached through consultation, all Cleared Contracts would terminate involuntarily (referred to as a “**Tear-Up**” scenario).

8. Participation in JSCC by Entities in Ontario

8.1 JSCC anticipates that banks, pension plans, asset managers, insurance companies and other entities that have a head office or principal place of business in Ontario may be interested in joining JSCC as IRS Clearing Participants or as customers of IRS Clearing Participants.

8.2 JSCC does not plan to clear instruments for Ontario Clearing Participants or Ontario Customers that are subject to mandatory clearing under National Instrument 94-101 *Mandatory Central Counterparty Clearing of Derivatives*, but JSCC will comply with applicable requirements thereunder if in the future it does clear instruments that are subject to mandatory clearing requirements thereunder.

8.3 In respect of compliance with trade reporting obligations under OSC Rule 91-507 *Trade Repositories and Derivatives Trade Reporting*, JSCC acknowledges that it shall be subject to the obligation to report to the OSC each derivatives transaction between JSCC and an Ontario local counterparty (including each Clearing Participant incorporated, resident, headquartered or having its principal place of business in Ontario) that arises as a result of its clearing of OTC IRS.

8.4 JSCC is subject to **NI 94-102** as a “regulated clearing agency” and is obliged to comply with Part 5 (Treatment of Customer Collateral by a Regulated Clearing Agency), Part 6 (Recordkeeping by a Regulated Clearing Agency), Part 7 (Reporting and Disclosure by a Regulated Clearing Agency) and Part 8 (Transfer of Positions) of NI 94-102 in respect of all clearing of IRS entered into by, for or on behalf of Ontario Clearing Participants or Ontario Customers, except as such requirements are varied by the 94-102 Exemption Order.

9. Criteria for Exemption from Recognition as a Foreign Clearing Agency

9.1 Section 2.1 of NI 24-102 requires a foreign clearing agency to provide the following information in its application for exemption from recognition as a clearing agency:

- (1) Its most recently completed PFMI Disclosure Framework Document (as defined in NI 24-102) together with disclosure about any material change to the information in the PFMI Disclosure Framework Document or concerning any information in the PFMI Disclosure Framework Document having become materially inaccurate for any reason.
- (2) Sufficient information to demonstrate that it is in compliance with the regulatory regime of the jurisdiction in which its head office or principal place of business is located.
- (3) Any additional relevant information sufficient to demonstrate that it is in the public interest for the securities regulatory authority to exempt the applicant. According to section 2.1 of the Companion Policy to NI 24-102, this additional information is a detailed description of the regulatory regime of the clearing agency’s home jurisdiction and the requirements imposed on the clearing agency, including how such requirements are similar to the requirements in Parts 3 and 4 of NI 24-102.

9.2 JSCC’s most recent PFMI Disclosure Framework Document, dated as of March 31, 2024, is available at: <https://www.jpjx.co.jp/jsc/en/company/fmi-pdf.html>. JSCC has confirmed that there have been no material changes to the matters addressed in the PFMI Disclosure Framework Document since the date of the document and it continues to be materially accurate.

PFMI Principles

9.3 A recognized clearing agency must establish, implement, and maintain rules, procedures, policies, or operations designed to ensure that it meets or exceeds PFMI Principles 1 to 3, 10, 13, 15 to 19, 20 other than key considerations 9, 21 to 23 and the following:

- (1) if the clearing agency operates as a CCP, PFMI Principles 4 to 9, 12 and 14;
- (2) if the clearing agency operates a securities settlement system, PFMI Principles 4, 5, 7 to 9 and 12; and
- (3) if the clearing agency operates as a central securities depository, PFMI Principle 11.

9.4 As set out in JSCC’s most recent PFMI Disclosure Framework Document, JSCC is compliant with all PFMI Principles applicable to it. Accordingly, the requirements in Part 3 of NI 24-102 are satisfied.

9.5 In the “Implementation monitoring of the PFMI: Level 2 assessment report for central counterparties and trade repositories – Japan” publicized by CPMI-IOSCO on February 26, 2015 (<https://www.iosco.org/library/pubdocs/pdf/IOSCOPD476.pdf>), Japan is rated as having completely and consistently adopted the PFMI applicable for CCPs licensed under the FIEA and trade repositories.

9.6 JSCC is licensed as the Financial Instruments Clearing Organization stipulated in Article 2, Paragraph 29 of the FIEA, and JSCC is regulated and supervised by the JFSA. A publicly available list of licensed Financial Instruments Clearing Organizations under the FIEA, which includes JSCC, is available at: <https://www.fsa.go.jp/en/regulated/licensed/index.html>.

10. Discussion on Requirements Set out in Part 4 of NI 24-102 and Compliance of JSCC

10.1 The regulatory requirements applicable to clearing agencies that are set out in Part 4 of NI 24-102 are generally also substantially imposed on JSCC directly or indirectly. In many cases, the FIEA and related regulations do not include specific prescriptive requirements stipulating the particular requirements set out in Part 4, but JSCC’s rules and policies (including the IRS Business Rules, which are binding on JSCC and are subject to FIEA review and approval) supplement the FIEA and related regulations in order to impose substantially similar restrictions on JSCC. In particular, we note that:

- (1) pursuant to Article 156-4 of the FIEA, in granting a license, the Prime Minister of Japan shall examine whether the provisions of the Business Rules are in conformity with laws and regulations and are sufficient for the proper and reliable performance of the clearing business;
- (2) the applicable Business Rules approved by the Prime Minister of Japan are the IRS Business Rules, which set out JSCC’s clearing rules for IRS;
- (3) JSCC may not amend the IRS Business Rules without the approval of the Prime Minister of Japan pursuant to Article 156-12 of the FIEA; and
- (4) the FIEA and the JFSA’s CCP Supervisory Guidelines (which is a binding supervisory guideline with respect to the application of laws and regulations and the operation of procedures for licensing and other regulatory actions) and the IRS Business Rules include specific provisions that are comparable to the NI 24-102 Part 4 requirements. The CCP Supervisory Guidelines are available at: <https://www.fsa.go.jp/common/law/202206.pdf>.

10.2 Each requirement in Part 4 of NI 24-102 is set out below in italics, followed by a description of (i) how the requirement is comparable to specific Japanese laws and regulations or JSCC’s IRS Business Rules, which JSCC is legally bound to uphold, and (ii) how JSCC complies with such laws and regulations, as applicable.

Division 1 – Governance

10.3 **Board of directors** (section 4.1 of NI 24-102)

- (1) *A recognized clearing agency must have a board of directors.*
- (2) *The board of directors must include appropriate representation by individuals who are*
 - (a) *independent of the clearing agency, and*
 - (b) *neither employees nor executive officers of a participant nor their immediate family members.*
- (3) *For the purposes of paragraph (2)(a), an individual is independent of a clearing agency if he or she has no direct or indirect material relationship with the clearing agency.*
- (4) *For the purposes of subsection (3), a “material relationship” is a relationship that could, in the view of the clearing agency’s board of directors, be reasonably expected to interfere with the exercise of a member’s independent judgment.*

Comparable provisions under Japanese laws and regulations

10.4 The FIEA (Article 156-4, Paragraph 1) requires that the personnel of a Financial Instruments Clearing Organization be composed of individuals each of whom “has sufficient knowledge and experience for conducting Financial Instruments Obligation Assumption Service appropriately and certainly and has sufficient social credibility”. Nominations to the Board of Directors are made in accordance with such requirements.

10.5 The CCP Supervisory Guidelines require a CCP to maintain effective disciplines for management and proper governance in order to ensure appropriate business operations and sound management, and in turn, financial system stability (Section III-1-1(1)).

10.6 The CCP Supervisory Guidelines also require, in cases where proposals for the appointment of outside directors are to be determined, that “the outside directors’ personal relationships and equity relationships with the CCP and other interests are verified and their independence, aptitude, etc. are carefully examined, in consideration of the roles they are expected to fulfill” (Section III-1-1(2)).

Compliance by JSCC

10.7 JSCC’s Board of Directors is composed of seven directors. Two directors are non-independent full-time directors (the President & CEO and one other member of management), and the other five are part-time directors, including academic and other experts.

10.8 Of the part-time Directors, three are associated with Clearing Participants or their affiliates, one is associated with JSCC’s parent company, JPX, and one is not employed by any of the Clearing Participants, their affiliates, JPX or JSCC (the “outside directors”).

10.9 JSCC’s Governance Guidelines set out the roles and responsibilities of the Board of Directors and independent directors’ qualifications.⁸ Pursuant to the specific nominating criteria established by the Board of Directors, JSCC appoints board members who have a broad range of relevant financial markets industry experience, qualifications, and industry knowledge. Pursuant to the Governance Guidelines, the Board must include “independent directors” that satisfy certain independence criteria.

10.10 Of the part-time directors, JSCC has determined that four are independent in accordance with the standards set out in JSCC’s Governance Guidelines, and that one is not independent by virtue of the fact that the person is currently an executive officer of JSCC’s parent company.

10.11 The members of the JSCC Board, with their current affiliations, are as follows:

- Konuma Yasuyuki President & CEO¹
- Isomoto Naoki Executive Officer¹
- Asai Kunihiro Senior Corporate Managing Director, Nikko Asset Management CO., Ltd.²
- Ohashi Kazuhiko Professor, Graduate School of Business Administration, Hitotsubashi University²
- Kato Izuru President, Representative Director, Chief Economist of Totan Research CO., Ltd.²
- Sakata Hideki Senior Managing Director, Global Markets, Nomura Securities CO., Ltd.²
- Sasaki Daishi Co-Head of Global Markets Company (in charge of Fixed Income, Foreign Exchange and Equities), Mizuho Financial Group, Inc.²
- Futagi Satoshi Senior Executive Officer, Japan Exchange Group, Inc.

Notes:

1. Full-time executive directors.
2. Independent under the Governance Guidelines

10.12 More information regarding the background of the members of the Board is available at: <https://www.jpx.co.jp/jsc/en/company/profile.html>.

10.13 JSCC believes that the outside directors, other than the outside director that is an officer of JPX, satisfy the independence criteria set out in NI 24-102 section 4.1(2).

10.14 **Documented procedures regarding risk spill-overs** (section 4.2 of NI 24-102)

The board of directors and management of a recognized clearing agency must have documented procedures to manage possible risk spill over where the clearing agency provides services with a different risk profile than its depository, clearing and settlement services.

⁸ Available at: https://www.jpx.co.jp/jsc/en/risk/cimhl00000005q9-att/GG_E.pdf.

10.15 This provision is not applicable to JSCC. JSCC only provides clearing services.

10.16 **Chief Risk Officer and Chief Compliance Officer** (section 4.3 of NI 24-102)

- (1) *A recognized clearing agency must designate a chief risk officer and a chief compliance officer, who must report directly to the board of directors of the clearing agency.*
- (2) *The chief risk officer must*
 - (a) *have full responsibility and authority to maintain, implement and enforce the risk management framework established by the clearing agency,*
 - (b) *make recommendations to the clearing agency's board of directors regarding the clearing agency's risk management framework,*
 - (c) *monitor the effectiveness of the clearing agency's risk management framework, and*
 - (d) *report to the clearing agency's board of directors on a timely basis upon becoming aware of any significant deficiency with the risk management framework.*
- (3) *The chief compliance officer must*
 - (a) *establish, implement, maintain and enforce written policies and procedures to identify and resolve conflicts of interest and ensure that the clearing agency complies with securities legislation,*
 - (b) *monitor compliance with the policies and procedures described in paragraph (a),*
 - (c) *report to the board of directors of the clearing agency as soon as practicable upon becoming aware of any circumstance indicating that the clearing agency, or any individual acting on its behalf, is not in compliance with securities legislation and one or more of the following apply:*
 - (i) *the non-compliance creates a risk of harm to a participant;*
 - (ii) *the non-compliance creates a risk of harm to the broader financial system;*
 - (iii) *the non-compliance is part of a pattern of non-compliance;*
 - (iv) *the non-compliance may have an impact on the ability of the clearing agency to carry on business in compliance with securities legislation,*
 - (d) *prepare and certify an annual report assessing compliance by the clearing agency, and individuals acting on its behalf, with securities legislation and submit the report to the board of directors,*
 - (e) *report to the clearing agency's board of directors as soon as practicable upon becoming aware of a conflict of interest that creates a risk of harm to a participant or to the capital markets, and*
 - (f) *concurrently with submitting a report under paragraphs (c), (d) or (e), file a copy of the report with the securities regulatory authority.*

Comparable provisions under Japanese laws and regulations

10.17 The FIEA and the CCP Supervisory Guidelines establish a comprehensive framework regarding governance, risk management and oversight for JSCC. Although these regulations do not stipulate the specific requirements found in section 4.3 of NI 24-102, as a practical matter, they may be viewed as analogous policy to section 4.3 of NI 24-102.

10.18 Article 156-4(1)(iv) of FIEA makes it a condition of granting a license of clearing organization, among other requirements, that the clearing organization ensure the procedures specified in its Business Rules conform to applicable laws and regulations and are sufficient to conduct the clearing services appropriately and with certainty.

10.19 CCP Supervisory Guidelines Section III-1-1 requires that a licensed clearing organization establish effective disciplines for management and proper governance, in order to ensure appropriate business operations and sound management, and in turn, financial system stability. Such provision provides further that “[e]ffective functioning of governance presumes that the components of the organization are fulfilling their primary roles.” For example, the CCP Supervisory Guidelines indicate that it is important that the board of directors and the Board of Statutory Auditors are able to check management, and checks and balances among divisions and the internal audit section are functioning properly.

B.11: CRO, Marketplaces, Clearing Agencies and Trade Repositories

- 10.20 Further, Articles 356 and 365 of the Companies Act⁹ provide for managing conflicts of interest between the Board of Directors and individual directors by requiring the disclosure of material facts to and approval from the Board in cases where a director seeks to engage in transactions competing against JSCC's business, or which would result in a conflict of interest.
- 10.21 Auditors are obligated by Article 381, Paragraph 1 and Article 384 of the Companies Act to report to the Board of Directors, without delay, illegal actions, violations of laws, regulations, or the Articles of Incorporation, or significantly inappropriate facts in relation to the duties of directors, as well as report the results of their investigations to the general shareholders meeting. As such, auditors investigate transactions involving conflicts of interest when preparing audit reports annually.
- 10.22 Article 369, Paragraph 2 of the Companies Act contains provisions prohibiting a director with a special interest in a subject matter from voting on such matter.
- 10.23 Pursuant to Article 335 of the Companies Act, a statutory auditor may not concurrently serve as a director, manager or other employee of a stock company or its subsidiary, or as an accounting counselor or executive officer of such subsidiary. In addition, in a company with a board of statutory auditors, there shall be at least three corporate auditors, at least half of whom shall be outside statutory auditors.

Compliance by JSCC

- 10.24 JSCC has a CRO who is independent from each Clearing Business and is the officer in charge of risk management. The CRO is accountable, and provides recommendations, to the Board of Directors and the Risk Oversight Committee.
- 10.25 As required by the CCP Supervisory Guidelines, JSCC's Board has developed a Risk Appetite Statement upon consultation with Clearing Participants, their customers, regulatory authorities, the officers and employees of JSCC, and other stakeholders. The Risk Appetite Statement clarifies the attitude towards risk management and the type and quantity of risk (including credit risk and liquidity risk, among others) that JSCC accepts, in order to realize its Corporate Philosophy and management policies.
- 10.26 The Risk Oversight Committee is an internal forum for the discussion and information-sharing of risk management issues, the status of implementation of the risk management system, compliance with JSCC's Risk Appetite Statement, the identification of material risks, and any required countermeasures. On a monthly basis, the Risk Oversight Committee reviews the results of stress tests and back-tests, and the status of compliance with risk management policies related to operational risk, system risk, and business continuity. The Risk Oversight Committee also receives and reviews various other reports, including the results of default fire drills, the results of investigations into the causes of operational errors or system failures and any mitigation measures, and confirmation of processing capacity targets and actual performance for each clearing system. The Risk Oversight Committee is comprised of the President & CEO, executive officers supervising each business unit, division heads, the CRO and other Risk Management Office staff, and auditors. The Risk Oversight Committee meets at least once per month.
- 10.27 The CRO reports the status of compliance with the Risk Management Policy on a monthly basis to the Risk Oversight Committee and offers proposals as necessary. Additionally, the CRO reports the status of compliance with the Risk Management Policy to the Board of Directors at least once per quarter and offers proposals as necessary.
- 10.28 In accordance with the Risk Management Policy, JSCC's Risk Management Division validates the overall risk management model at least annually, making recommendations regarding revisions to the relevant Clearing Business, as necessary. The reporting line of the Risk Management Division is independent from each Clearing Business, reporting directly to the CRO. This helps to ensure that the validation process conducted by the Risk Management Division is independent from the Clearing Businesses. The validation process verifies the effectiveness of the margin and clearing fund loss compensation model and specifications according to the prevailing market environment, and makes recommendations regarding revisions, as necessary. The results of the validations are reported to the Board of Directors and the advisory committees of each Clearing Business.
- 10.29 JSCC does not have a Chief Compliance Officer. However, JSCC has a Board of Statutory Auditors, in accordance with Article 326, Item 2 of the Companies Act, composed of three highly independent auditors nominated by the Board of Directors for election every four years at the general shareholders meeting. The Board of Statutory Auditors is independent from the board of directors and consists of Statutory Auditors each of whom is directly accountable to the company itself. The Statutory Auditors have the authority under the Companies Act to investigate company business and

⁹ An English translation of this legislation is available at:
<https://www.japaneselawtranslation.go.jp/en/laws/view/4135>;
<https://www.japaneselawtranslation.go.jp/en/laws/view/4136>.

assets, to request a meeting of the Board of Directors, and to report on the improper conduct of a director, as well as the obligation and responsibility to report results of audits to shareholders, to ensure the lawfulness of director's activities.

- 10.30 The Auditor's Office is a division within JSCC that supports the duties of the Statutory Auditors and works to facilitate smooth execution of the audit by the Statutory Auditors. It is independent from the Board and management of JSCC, reporting directly to the Statutory Auditors.
- 10.31 Separately, JSCC's Internal Audit Office reports to the President & CEO and is responsible for conducting audits to confirm the proper execution of JSCC's business. It reports its audit results to both the President & CEO and the Board of Statutory Auditors.
- 10.32 **Board or advisory committees** (section 4.4 of NI 24-102)
- (1) *The board of directors of a recognized clearing agency must, at a minimum, establish and maintain committees on risk management, finance and audit.*
 - (2) *If a committee is a board committee, it must be chaired by a sufficiently knowledgeable individual who is independent of the clearing agency.*
 - (3) *Subject to subsection (4), a committee must have an appropriate representation by individuals who are independent of the clearing agency.*
 - (4) *An audit or risk committee must have an appropriate representation by individuals who are:*
 - (a) *independent of the clearing agency, and*
 - (b) *neither employees nor executive officers of a participant nor their immediate family members.*
 - (5) *For the purpose of this section, an individual is independent of a clearing agency if the individual has no relationship with the agency that could, in the reasonable opinion of the clearing agency's board of directors, be expected to interfere with the exercise of the individual's independent judgment.*

Comparable provisions under Japanese laws and regulations

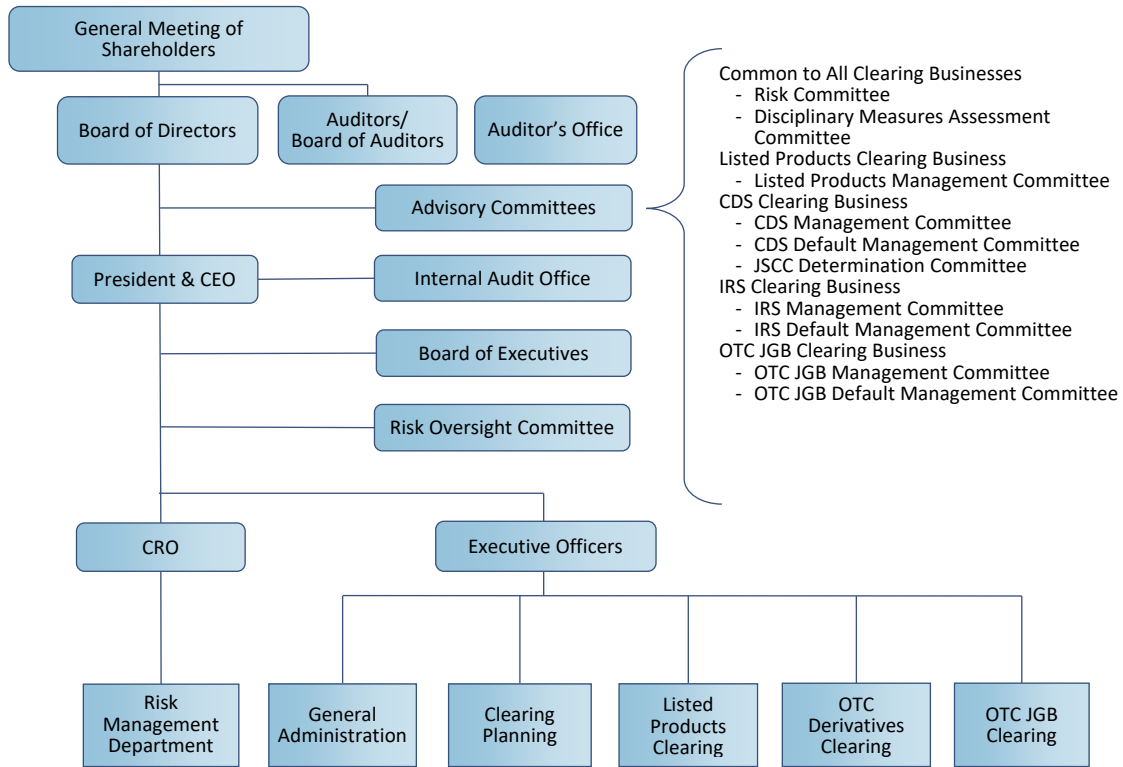
- 10.33 CCP Supervisory Guidelines Section III-1-1 requires that the CCP's Board of Directors take measures to objectively ensure the appropriateness and fairness of, for example, important management decisions and management judgments related to compliance and credit risk management, such as utilizing the advice of outside experts and discretionary committees whose members consist of outside experts, as necessary, when making such decisions and judgments.
- 10.34 JSCC has a Board of Statutory Auditors in accordance with Article 326, Item 2 of the Companies Act. This requirement is discussed above.

Compliance by JSCC

- 10.35 JSCC executes business plans based on resolutions of the Board of Directors, realizing JSCC's corporate philosophy, and overseeing day-to-day operations. The advisory committees of each Clearing Business, which are composed of representatives of Clearing Participants of the relevant Clearing Business and other individuals, also function to incorporate the opinions of Clearing Participants into JSCC's governance. The Articles of Incorporation include provisions to the effect that the Board of Directors will respect the opinions of advisory committees to establish proper governance.
- 10.36 JSCC has the following advisory committees that provide input to the IRS Clearing Business: Risk Committee, Disciplinary Measures Assessment Committee, IRS Management Committee, and IRS Default Management Committee.
- 10.37 In cases where JSCC intends to make decisions on any matter considered necessary in the performance of its responsibilities related to risks of the Clearing Businesses, JSCC would seek advice from the Risk Committee. The committee is composed of members that are external directors of JSCC, Clearing Participants, their customers, and other persons with excellent knowledge and experience in the matter under consultation. Currently, the total number of committee members is five, chaired by an independent director; JSCC appoints committee members from among (1) outside directors, (2) executives of clearing participants or clients who have excellent insight and are capable of making fair judgments regarding the matters to be consulted, and (3) persons other than those in (1) and (2) who have excellent insight and are capable of making fair judgments regarding the matters to be consulted.
- 10.38 As required by Article 2, Item 10 of the Companies Act, JSCC maintains a Board of Statutory Auditors, which serves the corresponding function as an audit committee. The duties of the Board of Statutory Auditors are defined in the Companies Act (in Article 390, Paragraph 2), and include duties such as preparing audit reports, appointing and removing full-time

statutory auditors, deciding audit policy, deciding the method to investigate the status of business and assets of the company, and other matters related to the execution of the auditor’s duties.

10.39 The following chart summarizes JSCC’s organizational structure:



Note:

- Effective as of April 1, 2024, “Clearing Planning” in the chart is planned to be divided into two separate divisions: “Clearing Planning Department” and “Strategic Planning for Clearing IT Innovation”.

Division 2 – Default management

10.40 **Use of own capital** (section 4.5 of NI 24-102)

A recognized clearing agency that operates as a central counterparty must dedicate and use a reasonable portion of its own capital to cover losses resulting from one or more participant defaults.

Comparable provisions under Japanese laws and regulations

10.41 The applicable Japanese regulations covering JSCC, while not mandating that a clearing organization apportion its own capital to cover default losses, impose a comprehensive framework and set of requirements addressing sound management by CCPs of participant default.

10.42 CCP Supervisory Guidelines section III-2-1 requires directors/board of directors of a licensed clearing organization to:

- have a general understanding of the nature and level of the risks taken by the clearing organization as well as the relationship between risk and the appropriate level of capital;
- understand that an appropriate capital plan is an essential component in order to achieve their strategic objectives, and formulate the capital plan according to the management issues of the clearing organization; and
- be sufficiently involved in formulating the aforementioned capital plan, and adopt a process for evaluating capital adequacy and implementing appropriate measures for maintaining a sufficient level of capital.

Compliance by JSCC

- 10.43 JSCC has established a financial safeguards system to provide robust risk management protections. The default waterfall of the IRS Clearing Business in respect of losses following participant defaults is described above in Part 7 of this application, and includes, at Steps 3 and 4, contributions by JSCC of specified amounts of JSCC Compensation Capital. Up to half of the JSCC Compensation Capital is required to be consumed before applying the IRS Clearing Fund deposits of non-defaulting Clearing Participants to cover such losses.
- 10.44 The total JSCC Compensation Capital in respect of the IRS Clearing Business amounts to JPY 4 billion. As of March 31, 2024, shareholders' equity for JSCC's IRS Clearing Businesses was JPY 12.7 billion (and for all JSCC's Clearing Businesses was JPY 98.5 billion).

Division 3 – Operational risk

- 10.45 **Systems requirements** (section 4.6 of NI 24-102)

For each system operated by or on behalf of a recognized clearing agency that supports the clearing agency's clearing, settlement and depository functions, the clearing agency must

- (a) *develop and maintain*
- (i) *adequate internal controls over that system, and*
 - (ii) *adequate cyber resilience and information technology general controls, including, without limitation, controls relating to information systems operations, information security, change management, problem management, network support and system software support,*
- (b) *in accordance with prudent business practice, on a reasonably frequent basis and, in any event, at least annually*
- (i) *make reasonable current and future capacity estimates, and*
 - (ii) *conduct capacity stress tests to determine the processing capability of that system to perform in an accurate, timely and efficient manner, and*
- (c) *promptly notify the regulator or, in Québec, the securities regulatory authority of any systems failure, malfunction, delay or security incident that is material, and provide timely updates to the regulator or, in Québec, the securities regulatory authority regarding the following:*
- (i) *any change in the status of the failure, malfunction, delay or security incident;*
 - (ii) *the resumption of service, if applicable;*
 - (iii) *the results of any internal review, by the clearing agency, of the failure, malfunction, delay or security incident; and*
- (d) *keep a record of any systems failure, malfunction, delay or security incident and whether or not it is material.*

Comparable provisions under Japanese laws and regulations

- 10.46 Under article 156-4(1)(iv) of the FIEA, a clearing organization is required to, as part of the approval process for licensing, demonstrate to the JFSA that the clearing organization has established an adequately developed structure and system for managing highly reliable facilities in order to facilitate settlement properly and reliably. Additionally, Paragraph 4 (ii) of Article 48 of the Cabinet Office Order on Financial Instruments Clearing Organizations (Cabinet Office Order No. 76 of December 6, 2002) requires CCPs to immediately report to the JFSA any "Incident(s)", which includes suspension of whole or part of clearing service due to a failure in an electronic data processing system or any other accidental cause. Once details of a reported Incident have become clear, a CCP must submit a report to the JFSA without delay with details of the Incident, improvement measures in response to the Incident, and other necessary matters pursuant to Paragraph 5 of the said Article 48.
- 10.47 CCP Supervisory Guideline Section III-3-4 requires that a clearing organization build a robust control environment for managing information technology risks. More specifically, it includes the following requirements applicable to CCPs such as JSCC:

Recognition of Information Technology Risk

- (1) The board of directors shall formulate a basic policy for company-wide management of information technology risk based on a full recognition of information technology risk.
- (2) The board of directors shall recognize that prevention and efforts for speedy recovery from system troubles and cybersecurity incidents ("system trouble, etc.") is an important issue and has developed an appropriate control environment.
- (3) There shall be arrangements and procedures for ensuring that information regarding information technology risk is properly reported to the management team.

Establishment of Appropriate Control Environment for Risk Management

- (4) The clearing organization shall specify a basic policy for the management of information technology risk and developed a relevant control environment.
- (5) The clearing organization shall designate the types of risk that should be managed according to specific criteria and has identified the location of the risk.
- (6) The control environment for managing information technology risk is effective enough to enable the clearing organization to identify and analyze the actual state of its business operations and system troubles, and minimize the frequency and scale of system troubles in a manner suited to the system environment and other factors, thereby maintaining an appropriate level of computer system quality.

Assessment of information technology risk

- (7) The division managing information technology risk shall recognize and assess risks periodically or in a timely manner by recognizing the fact that risks are becoming diversified due to changes in the external environment, such as seen in the examples of system troubles induced by large-scale transactions as a result of increased customer channels and efforts to enhance information networks that bring more diverse and broad-based impacts. Also, clearing organizations must take sufficient measures to address the risks that have been identified.

Management of information security

- (8) The clearing organization shall develop a policy to appropriately manage information assets, prepare organizational readiness, introduce in-house rules, etc., and develop an internal control environment. Also, a clearing organization must make continuous efforts to improve its information security control environment through the PDCA cycle, taking notice of illegal incidents or lapses at other companies.
- (9) The clearing organization shall manage information security by designating individuals responsible and clarifying their roles/responsibilities in efforts to maintain the confidentiality, integrity and availability of information. Also, the individuals responsible for information security shall be tasked to handle the security of system, data and network management.
- (10) The clearing organization shall take measures to prevent unauthorized use of computer systems, unauthorized access, and intrusion by malicious computer programs such as computer viruses.
- (11) The clearing organization shall identify important information of participants it is responsible for protecting in a comprehensive manner, keep its records and manage them. The clearing organization shall, in identifying important information of participants, set business operations, systems and external contractors as the scope of protection and include data, such as listed below, in the scope where it tries to identify those calling for protection.
 - (a) Data stored in the areas within the system that are not used in ordinary operations
 - (b) Data output from the system for analyzing system troubles, etc.
- (12) The clearing organization shall assess importance and risks regarding important information of participants that has been identified. Also, the clearing organization shall develop rules to manage information, such as those listed below, in accordance with the importance and risks of each piece.
 - (a) Rules to encrypt or mask information
 - (b) Rules for utilizing information

- (c) Rules on handling data storage media, etc.
- (13) The clearing organization shall introduce measures to discourage or prevent unauthorized access, unauthorized retrieval, data leakage, etc. such as listed below, for important information of participants.
 - (a) Provision of access authorizations that limits access to the scope necessary for the person's responsibility
 - (b) Storage and monitoring of access logs
 - (c) Introduction of mutual checking functions such as by separating the individuals in charge of development and those responsible for operations, administrators and those responsible for operations, etc.
- (14) The clearing organization shall introduce rules for controlling confidential information, such as encryption and masking. Also, whether it has introduced rules regarding the management of encryption programs, encryption keys, and design specifications for encryption programs.
- (15) Note that "confidential information" refers to information, such as PIN, passwords, etc., whose misuse could lead to losses by participants.
- (16) The clearing organization shall give due consideration to the necessity of holding/disposing of, restricting access to, and taking outside, of confidential information, and treat such information in a stricter manner.
- (17) The clearing organization shall periodically monitor its information assets to see whether they are managed properly according to management rules, etc. and reviews the control environment on an ongoing basis.
- (18) The clearing organization shall conduct security education (including by external contractors) to all officers and employees in order to raise awareness of information security.

Management of cybersecurity

- (19) The board of directors shall recognize the importance of cybersecurity amid increasingly sophisticated and cunning cyberattacks and introduce the necessary control environment.
- (20) The clearing organization shall introduce systems to maintain cybersecurity, such as listed below, in addition to making the organization more secure and introducing in-house rules, etc.
 - (a) Monitoring systems against cyberattacks
 - (b) Systems to report cyberattacks and public-relation systems when attacks occur
 - (c) Emergency measures by Computer Security Incident Response Teams and systems for early detection
 - (d) Systems of information collection and sharing through information-sharing organizations, etc.
- (21) The clearing organization shall introduce a multi-layered defense system against cyberattacks that combines security measures respectively for inbound perimeter control, internal network security control and outbound perimeter control.
 - (a) Security measures for inbound perimeter control (e.g. introduction of a firewall, anti-virus software, Intrusion Detection System, Intrusion Protection System etc.)
 - (b) Security measures for internal network security control (e.g. proper management of privileged IDs/passwords, deletion of unnecessary IDs, monitoring of execution of certain commands, etc.)
 - (c) Security measures for outbound perimeter control (e.g. retrieval and analysis of communication/event logs, detecting/blocking inappropriate communication, etc.)
- (22) The clearing organization shall implement measures to prevent damage from expanding when cyberattacks occur as listed below.
 - (a) Identification of IP addresses from which the cyberattacks originate and blocking off of attacks
 - (b) Functions to automatically spread out accesses when under DDoS attacks
 - (c) Suspension of the entire system or its part, etc.

- (23) The clearing organization shall introduce necessary measures for vulnerabilities in the system, such as updating of the operating system and application of security patches in a timely manner.
- (24) The clearing organization shall, as part of cybersecurity measures, assess its security levels by taking advantage of tests on network intrusion, vulnerability scanning or penetration tests, etc. and make efforts to improve security.
- (25) The clearing organization shall, when carrying out business operations using communication methods such as the Internet, introduce appropriate authentication methods in line with the risks associated with such transactions, such as listed below.
 - (a) Authentication methods that do not rely on fixed IDs or passwords, such as variable passwords and digital certificates
 - (b) Transaction authentication using transaction signatures by means of a hardware token, etc.
- (26) The clearing organization shall, when carrying out business operations using communication methods such as the Internet, introduce preventative measures in line with operations, such as listed below.
 - (a) Introduction of software that allows the clearing organization to detect virus infection of the participant's PC and issue a warning
 - (b) Adoption of methods to store digital certificates in mediums or devices separate from PCs used in the relevant business operation, such as IC cards
 - (c) Introduction of a system that allows the clearing organization to detect unauthorized log-ins, abnormal input, etc. and immediately notify such abnormalities to participants
- (27) The clearing organization shall develop contingency plans against potential cyberattacks, conduct exercises and review such plans. Also, the clearing organization shall participate in industry-wide exercises as necessary.
- (28) The clearing organization shall formulate plans to train the personnel responsible for cybersecurity and implement them.

System Planning, Development and Operational Management

- (29) The clearing organization shall formulate a medium/long-term development plan after having clarified its strategic policy for systems as part of its management strategy. The medium/long-term development plan shall be approved by the board of directors.
- (30) The clearing organization shall reveal the risks inherent to its existing systems on an ongoing basis, and make investments to maintain and improve the systems in a planned manner.
- (31) The clearing organization shall clarify its rules for approval of plans, development and transition in development projects.
- (32) The clearing organization shall specify the responsible person with respect to each development project and manage the progress based on the development plan.
- (33) Upon system development, the clearing organization shall conduct tests in an appropriate and sufficient manner, such as by preparing test plans and making user divisions participate.
- (34) For human resources development, the clearing organization shall formulate and implement specific plans to pass on the mechanism and development technologies of its existing systems and train personnel with expertise.

Computer System Audits

- (35) An internal audit section that is independent from the computer system division shall conduct periodic audits of the computer system.
- (36) The clearing organization shall conduct internal audits by subject matter about computer systems and take of (i.e., obtain) external audits by information system auditors.
- (37) The audited division shall account for all business operations involving information technology risk.

Management of Outsourcing of Business Operations

- (38) The clearing organization shall select outsourcees (including system subsidiaries) by evaluating and examining them based on selection criteria.
- (39) The clearing organization shall prescribe the allocation of roles and responsibilities, audit authority, subcontracting procedures, level of services rendered, etc. with the outsourcee in an outsourcing agreement. Also, the clearing organization shall present to outsourced contractors rules their employees are required to adhere to and security requirements, as well as defines them in contract forms, etc.
- (40) The clearing organization shall properly conduct risk management regarding outsourced business operations (including work further subcontracted) related to the computer system. In cases where system-related administrative processes are outsourced, the clearing organization shall properly conduct risk management according to the outsourced business operations related to the computer system.
- (41) The clearing organization shall periodically monitor the outsourced business operations (including work further subcontracted) to determine, as the outsourcer, that the outsourced business operations are properly conducted. Also, the clearing organization shall implement a system that allows the consigner to monitor and track the status of data of investors and participants being processed at outsourced contractors.

Contingency Plan

- (42) The clearing organization shall formulate a contingency plan and establish arrangements and procedures for dealing with emergencies.
- (43) The clearing organization shall base the details of its contingency plan on guides that allows it to judge objective levels of its details (such as “Guide to Formulate Contingency Plans at Financial Institutions” compiled by the Center for Financial Industry Information Systems).
- (44) The clearing organization shall, in developing a contingency plan, assume not only contingencies due to natural disasters but also system troubles, etc. due to internal or external factors. Also, the clearing organization shall assume risk scenarios of sufficient extent for cases such as a major delay in batch processing.
- (45) The clearing organization shall review assumed scenarios in its contingency plan by, for example, taking into consideration case studies of system troubles, etc. at other financial institutions, clearing organizations, fund clearing organizations, book-entry transfer institutions and trade repositories, and the results of deliberations at the Central Disaster Management Council, etc.
- (46) The exercises in accordance with the contingency plan shall involve the entire company and be periodically conducted jointly with outsourced contractors, etc.
- (47) The clearing organization shall introduce off-site backup systems for important systems whose failure could seriously affect business operations so that normal business operations can be speedily brought back.

Risk of System Updates, etc.

- (48) The clearing organization shall manage the risk of building new systems and updating existing systems (“system updates, etc.”), and ensure that its officers and employees fully recognize the risk.
- (49) The clearing organization shall establish arrangements and procedures for conducting tests. The test plan shall be suited to the nature of the system development necessitated by the system updates, etc.
- (50) The clearing organization shall enable itself to be proactively involved in the system updates, etc. when this task is outsourced.
- (51) The clearing organization shall make use of third-party evaluation, such as evaluation by a system auditor, when making judgment regarding important matters related to the system updates, etc.
- (52) The clearing organization shall develop a contingency plan for dealing with an unexpected incident.

Response to System Troubles

- (53) The clearing organization shall implement appropriate measures to avoid creating unnecessary confusion among investors, participants, etc. when system troubles, etc. occur and performs tasks towards the prompt recovery and operation of alternatives. Also, the clearing organization shall develop a worst-case scenario in preparation for system troubles and be prepared to take necessary measures accordingly.

- (54) The clearing organization shall prepare procedures that also subjects outsourced contractors to reporting system troubles, and have a clearly defined system of command and supervision.
- (55) The clearing organization shall be prepared to immediately notify the representative director and other directors when a system trouble that may significantly affect business operations occurs, and report the largest potential risk it poses under the worst-case scenario (for example, if there is a possibility that the failure could gravely affect investors or participants, the reporting persons should not underestimate the risk but immediately report the biggest risk scenario). In addition, the clearing organization shall be prepared to launch a task force, have the representative director issue appropriate instructions and orders, and seek resolution of the issue in a swift manner.
- (56) The clearing organization shall, after system troubles, etc. have occurred, analyze the cause and implement measures based on the analysis to prevent recurrence. Also, the clearing organization shall periodically analyze tendencies of factors that have led to system troubles, etc. and introduce measures to address them.
- (57) The clearing organization shall immediately report system troubles, etc. to the authorities.

Compliance by JSCC

- 10.48 JSCC has established a Risk Management Policy that clarifies the purpose, policies, and management of the risk management framework, including sound risk governance, stringent participant eligibility requirements, a robust margin framework, clearing fund and Loss Compensation Scheme, liquidity risk management, default management, and business continuity plan. The Risk Management Policy stipulates its basic policies for managing systemic risk, being that JSCC must:
 - (1) secure sufficient system processing capacity;
 - (2) conduct system development based on an appropriate plan with sufficient testing;
 - (3) prepare a contingency plan for the occurrence of system failures and cyber security incidents;
 - (4) establish information security measures; and
 - (5) manage outsourcing arrangements.
- 10.49 JSCC stipulates the details of these basic policies in the following internal policies and procedures:
 - (1) System Risk Management Policy;
 - (2) System Risk Management Rules;
 - (3) Information Security Basic Policies;
 - (4) Information Security Countermeasures Standards;
 - (5) Outsourcing Management Rules; and
 - (6) Manual for Handling Incidents Suspected of Cyberterrorism.
- 10.50 The System Risk Management Policy and System Risk Management Rules address risks arising from IT system use. The Information Security Basic Policies and Information Security Countermeasure Standards provide for access control and information protection. The Rules for Management of Outsourcing provide for vendor selection processes and continuous monitoring and control of outsourced activities.
- 10.51 Pursuant to JSCC's incident management procedures, should an unexpected event occur, such as a system failure, JSCC would investigate the cause and devise measures to prevent reoccurrence. If JSCC's management determines the event to be significant, the event would be reported to the Risk Management Committee. The following levels of impact with respect to system failures are subject to reporting to the Risk Management Committee:
 - (1) Level S: Severe system failure that affects the core CCP operations;
 - (2) Level A: System failure that affects the core CCP operations;
 - (3) Level B: System failure that affects external parties, but does not affect the core CCP operations; and
 - (4) Level C: System failure with limited external impact or no external impact, but internal impact.

In addition to such event reporting, JSCC reports system capacity and processing capabilities, system development status, and outsourcing management status to the Risk Oversight Committee. Through these processes, JSCC continuously controls System Risk.

- 10.52 JSCC has Operational Procedures in place for each Clearing Business. The Operational Procedures prescribe operational procedures for Clearing Participants based on JSCC's Business Rules. The objective of the Operational Procedures is to realize smooth clearing operations with Clearing Participants. Additionally, JSCC stipulates certain "System Connection Specifications" to realize stable system operations with Clearing Participants. These Operational Procedures and System Connection Specifications clarify operational details and deadlines to avoid misunderstanding with Clearing Participants, and facilitate operational risk management. When changing operational procedures and implementing new products, these documents are revised as necessary and system testing is performed with Clearing Participants in advance to evaluate the performance of the changes. Furthermore, for the replacement of critical systems, or similar large development projects, JSCC seeks evaluation by external experts, when necessary.
- 10.53 JSCC regularly confirms that all critical systems have sufficient processing capacity for current levels of utilization and forecasted future requirements. On a monthly basis, management of JSCC presents capacity targets and actual performance data regarding JSCC systems to the Risk Oversight Committee, allowing it to monitor and evaluate the sufficiency of system capacity and processing capabilities.
- 10.54 JSCC has put in place the following measures to ensure its systems have sufficient processing capabilities:
- (1) all critical systems are required to have sufficient processing capacity to handle a steep increase in processing volume; and
 - (2) a warning threshold has been implemented into monitoring procedures, which triggers if utilization exceeds certain threshold set according to the features of each system. This ensures that measures can be implemented to increase the system capacity well in advance of the required time frame.
- 10.55 JSCC conducts stress testing at least daily to determine whether pre-funded loss compensation financial resources, including margin, clearing fund, and JSCC's contribution, are sufficient to cover potential losses, as well as whether the total loss compensation resources, comprised of the aforementioned pre-funded resources plus additional contributions from Clearing Participants, are sufficient to cover the potential losses.
- 10.56 JSCC stipulates the retention period of documents related to important meetings (i.e., general meetings of shareholders, meetings of the board of directors, meetings of the executive officers, meetings of each committee, and similar meetings) and such documents are retained permanently. Documents deemed important for the performance of the core business of each department are retained for 20 years.
- 10.57 **Auxiliary systems** (section 4.6.1 of NI 24-102)
- (1) *In this section, "auxiliary system" means a system, other than a system referred to in section 4.6, operated by or on behalf of a recognized clearing agency that, if breached, poses a security threat to another system operated by or on behalf of the recognized clearing agency that supports the recognized clearing agency's clearing, settlement or depository functions.*
 - (2) *For each auxiliary system, a recognized clearing agency must*
 - (a) *develop and maintain adequate information security controls that address the security threats posed by the auxiliary system to the system that supports the clearing, settlement or depository functions,*
 - (b) *promptly notify the regulator or, in Québec, the securities regulatory authority of any security incident that is material and provide timely updates to the regulator or, in Québec, the securities regulatory authority on*
 - (i) *any change in the status of the incident,*
 - (ii) *the resumption of service, if applicable, and*
 - (iii) *the results of any internal review, by the clearing agency, of the security incident, and*
 - (c) *keep a record of any security incident and whether or not it is material.*

Comparable provisions under Japanese laws and regulations

- 10.58 The requirements described above in paragraphs 10.46 and 10.47 apply to all systems of a clearing organization, regardless of whether the systems directly support the clearing organization's clearing, settlement and depository functions or are only auxiliary systems.

Compliance by JSCC

- 10.59 Pursuant to the definition under section 4.6.1 of NI 24-102, auxiliary systems of JSCC are those that, if breached, would pose a security threat to the "core" system operated by or on behalf of JSCC that supports JSCC's clearing, settlement or depository functions. JSCC has no auxiliary systems because its core system is strictly segregated from other associated systems pursuant to its System Risk Management Policy and associated rules. Non-core systems can affect JSCC in other ways, however; for example, if the OTC trade reporting tool, which creates trade reporting files in the format of the relevant trade repositories from the trade data delivered from the core system via standalone terminals, experiences technical issues, this would impact JSCC's ability to timely comply with its reporting obligations. JSCC applies certain information security standards to those systems, including maintaining antivirus software protections.

- 10.60 **Systems reviews** (section 4.7 of NI 24-102)

- (1) *A recognized clearing agency must*
- (a) *on a reasonably frequent basis and, in any event, at least annually, engage a qualified external auditor to conduct an independent systems review and prepare a report, in accordance with established audit standards and best industry practices, that assesses the clearing agency's compliance with paragraphs 4.6(a) and 4.6.1(2)(a) and section 4.9, and*
 - (b) *on a reasonably frequent basis and, in any event, at least annually, engage a qualified party to perform assessments and testing to identify any security vulnerability and measure the effectiveness of information security controls that assess the clearing agency's compliance with paragraphs 4.6(a) and 4.6.1(2)(a).*
- (2) *The clearing agency must provide the report resulting from the review conducted under paragraph (1)(a) to*
- (a) *its board of directors, or audit committee, promptly upon the report's completion, and*
 - (b) *the regulator or, in Québec, the securities regulatory authority, by the earlier of the 30th day after providing the report to its board of directors or the audit committee or the 60th day after the calendar year end.*

Comparable provisions under Japanese laws and regulations

- 10.61 As described above in paragraphs 10.47 (35) through (37), CCP Supervisory Guideline Section III-3-4(2)(vii) requires a clearing organization to have an internal audit section that is independent from the computer system division that conducts periodic audits of the computer system, and to engage external auditors to perform audits of the information system. The clearing organization is not specifically required to provide the external auditors' report to the board or JFSA; however, as described above in paragraphs 10.47 (1), (2), (19) and (29), Section III-3-4 of the CCP Supervisory Guideline imposes responsibilities of the board of directors of clearing organizations, including to have a "full recognition of information technology risk" and to develop an appropriate control environment with respect to prevention of and speedy recovery from system troubles and cybersecurity incidents, and to achieve them, the board of directors needs to be well informed. In practice, TSE, which owns the primary system processes used in JSCC's Clearing Businesses, periodically conducts outside auditing and reports the outcomes to JSCC (and the JFSA, if necessary).

Compliance by JSCC

- 10.62 JSCC applies industry best practice for development, implementation, operations, monitoring, management and maintenance of IT systems, using industry-standard hardware and processes for which experienced resources are readily available.
- 10.63 JSCC's Risk Management Division is responsible for confirming each division's compliance with the Risk Management Policy, while the Internal Audit Office is responsible for conducting audits to confirm the proper execution of business by each department, including the Risk Management Division. The auditing of each Clearing Business is conducted with cooperation between both the Risk Management Division and the Internal Auditing Office.
- 10.64 For systems developed by external companies, JSCC has established a workflow to obtain internal and external audit-related materials from the external contractor and evaluate them. If audit-related materials cannot be obtained from the

external contractor on a regular basis, JSCC would carry out an evaluation to confirm the appropriateness of the business execution status, including system maintenance, operation, and monitoring, and outsourced system risk is evaluated against JSCC's monitoring standards for outsourced operations. Such evaluations are reported to the CEO.

10.65 JSCC's "Information Security Basic Policies" provides policies and a management framework for appropriately handling information assets. In the "Information Security Countermeasure Standards", which is based on the "Information Security Basic Policies", JSCC stipulates information security matters to be handled in relation to its information and information systems. These include management of connections to external networks, anti-virus measures, and the establishment of system access procedures. When establishing the "Information Security Basic Policies" and "Information Security Countermeasure Standards," JSCC consulted with experts on industry standards. On an annual basis, the Division responsible for JSCC's information security confirms compliance conditions with the "Information Security Basic Policies" and "Information Security Countermeasure Standards". If it is determined that the current criteria are not appropriate, due to a change in industry standards, advancement of technology, or other reasons, the criteria would be revised and updated. Additionally, JSCC has confirmed that the outsourcee for the clearing system has stipulated technology security objectives for JSCC's clearing system, which satisfies the certification criteria of ISO27001/ISMS.

10.66 **Clearing Agency technology requirements and testing facilities** (section 4.8 of NI 24-102)

- (1) *A recognized clearing agency must make available to participants, in their final form, all technology requirements regarding interfacing with or accessing the clearing agency*
 - (a) *if operations have not begun, sufficiently in advance of operations to allow a reasonable period for testing and system modification by participants, and*
 - (b) *if operations have begun, sufficiently in advance of implementing a material change to technology requirements to allow a reasonable period for testing and system modification by participants.*
- (2) *After complying with subsection (1), the clearing agency must make available testing facilities for interfacing with or accessing the clearing agency*
 - (a) *if operations have not begun, sufficiently in advance of operations to allow a reasonable period for testing and system modification by participants, and*
 - (b) *if operations have begun, sufficiently in advance of implementing a material change to technology requirements to allow a reasonable period for testing and system modification by participants.*
- (3) *The clearing agency must not begin operations before*
 - (a) *it has complied with paragraphs (1)(a) and (2)(a), and*
 - (b) *the chief information officer of the clearing agency, or an individual performing a similar function, has certified in writing to the regulator or, in Québec, the securities regulatory authority, that all information technology systems used by the clearing agency have been tested according to prudent business practices and are operating as designed.*
- (4) *The clearing agency must not implement a material change to the systems referred to in section 4.6 before*
 - (a) *it has complied with paragraphs (1)(b) and (2)(b), and*
 - (b) *the chief information officer of the clearing agency, or an individual performing a similar function, has certified in writing to the regulator or, in Québec, the securities regulatory authority, that the change has been tested according to prudent business practices and is operating as designed.*
- (5) *Subsection (4) does not apply to the clearing agency if the change must be made immediately to address a failure, malfunction or material delay of its systems or equipment and if*
 - (a) *the clearing agency immediately notifies the regulator or, in Québec, the securities regulatory authority, of its intention to make the change, and*
 - (b) *the clearing agency discloses to its participants the changed technology requirements as soon as practicable.*

Comparable provisions under Japanese laws and regulations

10.67 CCP Supervisory Guideline section III-3-8 (2)(i) requires a clearing organization to formulate clear and comprehensive rules and procedures, disclose them to Clearing Participants and publicly disclose key rules and procedures.

Compliance by JSCC

- 10.68 JSCC's Operational Procedures have been established to facilitate smooth clearing operations with Clearing Participants. They set out detailed procedures, including for clearing, transfer of funds, and the deposit of margin. JSCC also provides System Connection Specifications to new and existing Clearing Participants, which set out technology requirements regarding interfacing with or accessing JSCC systems with a view to realizing stable system operations with Clearing Participants. These Operational Procedures and System Connection Specifications clarify operational details and deadlines to avoid misunderstanding with Clearing Participants, and facilitate operational risk management. They are available to all Clearing Participants in final form.
- 10.69 When changing operational procedures and implementing new products, these documents are revised as necessary and system testing is performed with applicable Clearing Participants in advance, allowing for verification and evaluation. JSCC provides explanatory sessions to familiarize Clearing Participants with JSCC's rules and procedures, when required, such as when revising rules or introducing new products. Also, JSCC reports to the JFSA on system testing related to any material system developments and modifications.
- 10.70 **Testing of business continuity plans** (section 4.9 of NI 24-102)
- A recognized clearing agency must*
- (a) *develop and maintain reasonable business continuity plans, including disaster recovery plans, and*
- (b) *test its business continuity plans, including its disaster recovery plans, according to prudent business practices and on a reasonably frequent basis and, in any event, at least annually.*

Comparable provisions under Japanese laws and regulations

- 10.71 Section III-3-2 of the CCP Supervisory Guidelines require a CCP to formulate an appropriate business continuity plan ("BCP") in order to recover its operations as soon as possible and continue its operations even in the event of an emergency, e.g., acts of terrorism or large-scale disasters. CCPs are required to back up business data in a timely manner and periodically conduct drills such as switching over to the backup center.

Compliance by JSCC

- 10.72 To handle operational risk, JSCC has defined a "Business Continuity Basic Plan" and its related documents (collectively, the "**BCP Basic Plan**") to minimize the impact of interruptions to operations and lay out business continuity measures in case of the realization of various risk factors. If an event occurs that threatens JSCC's business continuity, JSCC would take measures based on the BCP Basic Plan to prevent and control factors that could harm business continuity.
- 10.73 The BCP Basic Plan stipulates that, if a risk event causes entire or partial operation interruption, JSCC would take measures to enable prompt recovery and resumption of material business operations. To facilitate this, the BCP Basic Plan stipulates that JSCC should employ secure system redundancy and establish back-up data centers and back-up offices. Therefore, JSCC expects to be able to continue its operations even in the event of a BCP scenario.
- 10.74 The BCP Basic Plan is designed to enable full recovery of its business operations within two hours of the occurrence of a risk event such as a terrorist attack or natural disaster. It also sets forth communication flow with internal and external critical stakeholders and regulators.
- 10.75 JSCC maintains a secondary site in addition to its primary site. Clearing systems are located at both sites and are equipped with the same level of processing capacity. The secondary site is maintained as an active site, which allows for swift switchover from the primary site. Full-time system operations personnel are assigned to the secondary site. JSCC's primary and secondary sites are geographically separated with different power and communications infrastructure. JSCC believes there is an extremely low probability of both sites simultaneously being affected by disasters. A full detailed analysis of the risk profile of the site was conducted at the time the secondary site was selected.
- 10.76 To verify the adequacy and effectiveness of the BCP Basic Plan, JSCC conducts BCP fire-drills at least once a year. These fire-drills include data synchronization to the back-up data center, regular data center switchover tests, back-up office maintenance, running operations from the back-up center, updating manuals based on the BCP Basic Plan, and staff BCP education.
- 10.77 JSCC participates, alongside other FMIs, such as the BOJ and Japan Securities Depository Center, Inc., in an industry-wide BCP exercise organized by the Japan Securities Dealers Association and Japanese Bankers Association, or BCP exercise organized by another FMI, at least once per year. These exercises assume a wide-area disaster and involve a broad scope of institutions. Based on the results and opinions or recommendations arising from these exercises, JSCC amends the BCP Basic Plan as necessary.

10.78 JSCC makes reports regarding the matters above to the Risk Oversight Committee. Through this process, JSCC continually confirms the effectiveness of its business continuity framework.

10.79 **Outsourcing** (section 4.10 of NI 24-102)

If a recognized clearing agency outsources a critical service or system to a service provider, including to an affiliated entity of the clearing agency, the clearing agency must do all of the following:

- (a) *establish, implement, maintain and enforce written policies and procedures to conduct suitable due diligence for selecting service providers to which a critical service and system may be outsourced and for the evaluation and approval of those outsourcing arrangements;*
- (b) *identify any conflicts of interest between the clearing agency and the service provider to which a critical service and system is outsourced, and establish, implement, maintain and enforce written policies and procedures to mitigate and manage those conflicts of interest;*
- (c) *enter into a written contract with the service provider to which a critical service or system is outsourced that*
 - (i) *is appropriate for the materiality and nature of the outsourced activities,*
 - (ii) *includes service level provisions, and*
 - (iii) *provides for adequate termination procedures;*
- (d) *maintain access to the books and records of the service provider relating to the outsourced activities;*
- (e) *ensure that the securities regulatory authority has the same access to all data, information and systems maintained by the service provider on behalf of the clearing agency that it would have absent the outsourcing arrangements;*
- (f) *ensure that all persons conducting audits or independent reviews of the clearing agency under this Instrument have appropriate access to all data, information and systems maintained by the service provider on behalf of the clearing agency that such persons would have absent the outsourcing arrangements;*
- (g) *take appropriate measures to determine that the service provider to which a critical service or system is outsourced establishes, maintains and periodically tests a reasonable business continuity plan, including a disaster recovery plan;*
- (h) *take appropriate measures to ensure that the service provider protects the clearing agency's proprietary information and participants' confidential information, including taking measures to protect information from loss, thefts, vulnerabilities, threats, unauthorized access, copying, use and modification, and discloses it only in circumstances where legislation or an order of a court or tribunal of competent jurisdiction requires the disclosure of such information;*
- (i) *establish, implement, maintain and enforce written policies and procedures to monitor the ongoing performance of the service provider's contractual obligations under the outsourcing arrangements.*

Comparable provisions under Japanese laws and regulations

10.80 Section III-3-3(2)(iii) of the CCP Supervisory Guidelines requires a clearing organization, in cases where it outsources part of its administrative processes to service providers or other third parties or relies on them, to confirm that the outsourcee fulfills the requirements that would have to be met if such processes were carried out by the clearing organization itself.

10.81 CCP Supervisory Guidelines section III-3-4(2)(viii) require a clearing organization:

- (1) to select outsourcees (including system subsidiaries) by evaluating and examining them based on selection criteria;
- (2) to prescribe the allocation of roles and responsibilities, audit authority, subcontracting procedures, level of services rendered, etc. with the outsourcee in an outsourcing agreement;
- (3) to present to outsourced contractors rules their employees are required to adhere to and security requirements, as well as define them in contract forms, etc.;

- (4) to conduct risk management regarding outsourced business operations (including work further subcontracted) related to the computer system properly;
- (5) to conduct risk management according to the outsourced business operations related to the computer system properly, in cases where system-related administrative processes are outsourced;
- (6) to monitor the outsourced business operations (including work further subcontracted) periodically to determine, as the outsourcer, that the outsourced business operations are properly conducted; and
- (7) to establish a system that allows the consigner to monitor and track the status of data of investors and participants being processed at outsourced contractors.

Compliance by JSCC

- 10.82 JSCC appropriately manages outsourcing arrangements according to clearly defined outsourcing guidelines and criteria. JSCC's Risk Management Policy stipulates the basic policies for managing System Risk, and JSCC maintains detailed policies and procedures to achieve these basic policies. These are discussed in more detail in paragraphs 5.4, 10.48 and 10.49 above.
- 10.83 Further to the Risk Management Policy, JSCC has established Outsourcing Management Rules that stipulate the management operations for an outsourcee, including JSCC's management system, selection and contracting of an outsourcee, ordering and management of subcontracted work, monitoring and review of subcontracted content, reporting of an outsourcee's management status, and responses after contract expiration. JSCC also maintains Outsourcing Selection Criteria that stipulate the risk assessment to be used for outsourcing, the clarification of necessary measures, and the confirmation of contractual details with an outsourcee.
- 10.84 JSCC outsources primary system processes for its Clearing Businesses to TSE pursuant to an outsourcing agreement. TSE is a JPX subsidiary, and therefore affiliated with JSCC. JSCC evaluates the associated risks according to its Outsourcing Management Rules and Outsourcing Selection Criteria. JSCC usually develops non-primary systems, such as end-user computing and trade reporting tools, by itself.
- 10.85 Should an unexpected event occur, such as a system failure, JSCC would investigate the cause and devise measures to prevent their reoccurrence, which would be reported to the Risk Management Committee, depending on significance and impact. In addition to this, JSCC reports system capacity and processing capabilities, system development status, and outsourcing management status to the Risk Oversight Committee. Through this process, JSCC continuously controls System Risk.
- 10.86 Additionally, JSCC has confirmed that the outsourcee for the clearing system has stipulated technology security objectives for JSCC's clearing system, and satisfies the certification criteria of ISO27001/ISMS.
- 10.87 Further, JSCC identifies risks related to system development and operations on the side of outsourcees and regularly confirms the status of response measures, in addition to confirming the satisfaction of reliability and contingency criteria by regularly holding switchover drills with such outsourcees.

Division 4 – Participation requirements

- 10.88 **Access requirements and due process** (section 4.11 of NI 24-102)
- (1) *A recognized clearing agency must not*
 - (a) *unreasonably prohibit, condition or limit access by a person or company to the services offered by the clearing agency,*
 - (b) *unreasonably discriminate among its participants or indirect participants,*
 - (c) *impose any burden on competition that is not reasonably necessary and appropriate,*
 - (d) *unreasonably require the use or purchase of another service for a person or company to utilize the clearing agency's services offered by it, and*
 - (e) *impose fees or other material costs on its participants that are unfairly or inequitably allocated among the participants.*
 - (2) *For any decision made by the clearing agency that terminates, suspends or restricts a participant's membership in the clearing agency or that declines entry to membership to an applicant that applies to become a participant, the clearing agency must ensure that*

- (a) *the participant or applicant is given an opportunity to be heard or make representations, and*
 - (b) *it keeps records of, gives reasons for, and provides for reviews of its decisions, including, for each applicant, the reasons for granting access or for denying or limiting access to the applicant, as the case may be.*
- (3) *Nothing in subsection (2) limits or prevents the clearing agency from taking timely action in accordance with its rules and procedures to manage the default of one or more participants or in connection with the clearing agency's recovery or orderly wind-down, whether or not such action adversely affects a participant.*

Comparable provisions under Japanese laws and regulations

- 10.89 Under article 156-7.2(3) of the FIEA, a clearing organization is required to, as part of the approval process for licensing, demonstrate to the JFSA that the clearing organization has participation requirements/criteria for the admission of clearing participants in its Business Rules. Article 156-9 of the FIEA prohibits a clearing organization from giving unjust discriminatory treatment to a particular clearing participant.
- 10.90 Sections III-3-1-2(1) and (2) of the CCP Supervisory Guidelines require a clearing organization, given the role of clearing organizations, which is to contribute to the stable and efficient business operations of market participants by intensively processing clearing service in financial transactions, to provide fair and open services to participants as follows:
- (1) a clearing organization shall examine whether its participation requirements are fair from the viewpoint of providing clearing services in a stable manner in the market of operations, and disclose the participation requirements to the public; and
 - (2) a clearing organization shall not abuse its position in such circumstance as using information received from clearing operations in other services and concluding contracts on services incidental to clearing operations.

Compliance by JSCC

- 10.91 JSCC has established criteria for the acquisition and maintenance of Clearing Qualifications for each of JSCC's Clearing Businesses. In respect of the IRS Clearing Business, such qualifications are set out in Chapter 2 of the Rules. Each Clearing Business' criteria are rationally aligned with the risks and nature of that business, do not impose excessive restrictions on entities' eligibility for participation, and ensure open access to those applying for Clearing Qualification. JSCC places no limitations on the attributes of Clearing Participants' customers and does not charge fees that limit participation.
- 10.92 Participation criteria broadly cover a Clearing Participant's management structure, financial requirements and business structure.
- 10.93 The participation criteria are stipulated in the Business Rules of each Clearing Business and have been approved by JSCC's domestic regulators. This approval is based on the FIEA's prohibition of discriminatory treatment (FIEA Article 156-9), and affirms the requirement for open access.
- 10.94 When JSCC determines that a Clearing Participant does not satisfy the participation criteria or has violated JSCC's rules, JSCC would take disciplinary measures against the Clearing Participant according to the methods prescribed in the Business Rules¹⁰. Before determining the measures, JSCC would consult with the Disciplinary Measures Assessment Committee regarding the appropriateness of the measures. The Disciplinary Measures Assessment Committee is composed of multiple experts, including lawyers and academics, and is independent from JSCC. The Disciplinary Measures Assessment Committee Rules stipulates that a committee member having any special interest in an agenda item is not allowed to participate in the relevant deliberation. These measures include issuing instructions on business structure or position improvement, the suspension of all or part of its clearing services and revocation of a Clearing Qualification for the relevant Clearing Participant. Prior to undertaking these measures, JSCC may request the submission of materials or conduct an on-site examination to gain a better understanding of the Clearing Participant's finances, management, and business structure, if JSCC deems such a request necessary to ensure the stable operations of the Clearing Business. In order to promote improvement at the Clearing Participant, JSCC may recommend appropriate measures based on its rules. If JSCC suspends clearing for a Clearing Participant or revokes a Clearing Participant's Clearing Qualification, it would notify all relevant stakeholders, including other Clearing Participants and market operators, and make a public announcement. In reviewing a Participant's application, JSCC would conduct hearings prior to any rejection, and would keep records appropriately.

¹⁰ See IRS Clearing Business Rules Chapter 2, Section 6.

11. Additional Information to Demonstrate that it is in the Public Interest for the OSC to Exempt the Applicant

- 11.1 JSCC has confirmed that it is committed to operating as a clearing agency in accordance with applicable Japanese laws and regulatory requirements and relevant public interest considerations and that it recognises the importance of maintaining the highest standards of corporate governance. JSCC's Corporate Philosophy highlights its commitment to maintaining a solid risk-management framework, and to contributing to the sustainable development of the markets by improving the efficiency, serviceability and safety of the markets as a post-trade processing infrastructure.
- 11.2 We respectfully submit that it is in the public interest for Ontario market participants to be able to facilitate protection of their assets and reduce risk by becoming Clearing Participants of JSCC or customers of Clearing Participants of JSCC. This will also have the advantage of furthering the goal of efficient and competitive capital markets in Canada by placing Ontario market participants on an equal footing with their global competitors.

12. Certification Regarding Books and Records as well as Onsite Inspection and Examination

- 12.1 Pursuant to paragraph 2.1(2) of NI 24-102, JSCC has provided a certification that it will, if so requested, (a) assist the OSC in accessing JSCC's books and records and in undertaking an onsite inspection and examination at JSCC's premises and (b) provide the OSC with an opinion of legal counsel that JSCC has, as a matter of law, the power and authority to (i) provide the OSC with prompt access to its books, records and other documents; and (ii) submit to onsite inspection and examination by the OSC.

13. Form 24-102F1 Submission to Jurisdiction and Appointment of Agent for Service

- 13.1 Pursuant to subsection 2.1(3) of NI 24-102, JSCC has provided an executed Form 24-102F1 *Submission to Jurisdiction and Appointment of Agent for Service*.

14. Notice Regarding Material Change to Information Provided in Application

- 14.1 Pursuant to subsection 2.1(4) of NI 24-102, JSCC agrees to inform the OSC in writing of any material change to the information provided in this application, or if any of the information becomes materially inaccurate for any reason, as soon as the change occurs or JSCC becomes aware of any material inaccuracy.

15. Filing of Audited Financial Statements

- 15.1 Pursuant to subsection 2.4(1) of NI 24-102, JSCC will provide audited financial statements prepared in accordance with Japanese GAAP for the most recently completed financial year. Such audited financial statements and the accompanying auditor's report will meet the standards prescribed in subsections 2.4(2) and (3) of NI 24-102, respectively.

16. Publication of JSCC's Application Letter

- 16.1 JSCC acknowledges that the OSC may publish this application letter for a 30-day public comment period.

* * * * *

We have attached a certificate of verification signed by JSCC as Schedule A and a draft of the Exemption Order for your consideration as Schedule B.

JSCC acknowledges that the scope of the order granted pursuant to this application and the terms and conditions imposed by the order may change as a result of the monitoring by the Ontario Securities Commission of developments in international and domestic capital markets or JSCC's activities, or as a result of any changes to the laws in Ontario affecting trading in derivatives or securities.

Payment of the filing fee of C\$83,000 has been previously submitted to you.

Should you have any questions on this application, please contact the undersigned at (416) 863-3842 or tim.phillips@blakes.com.

Yours very truly,

"Tim Phillips"

Tim Phillips

c: Mr. Konuma Yasuyuki, President & CEO, JSCC
Mr. Otashiro Tetsuo, Director, Global Policy and Regulation, JSCC
Chris Barker, Blake, Cassels & Graydon LLP

SCHEDULE A

CERTIFICATE OF VERIFICATION

To: Ontario Securities Commission

The undersigned hereby authorizes the making and filing of the attached application and confirms the truth of the facts contained therein.

Dated this 1st day of July, 2024.

Japan Securities Clearing Corporation

By: "KONUMA Yasuyuki" (signed)

Name: Mr. KONUMA Yasuyuki

Title: President & CEO

APPENDIX A

Form of Exemption Order

IN THE MATTER OF
THE SECURITIES ACT,
R.S.O. 1990, CHAPTER S.5,
AS AMENDED
(the OSA)

AND

IN THE MATTER OF
JAPAN SECURITIES CLEARING CORPORATION

ORDER
(Section 147 of the OSA)

WHEREAS the Ontario Securities Commission (**Commission**) has received an application (**Application**) from the Japan Securities Clearing Corporation (**JSCC**) pursuant to section 147 of the OSA requesting an order exempting JSCC from the requirement to be recognized as a clearing agency under subsection 21.2(0.1) of the OSA in order to provide its central counterparty (**CCP**) clearing service for interest rate swaps (**IRS**) to Ontario-resident entities (**Order**);

AND WHEREAS on September 29, 2023, the Commission issued an order that exempted JSCC on an interim basis (**Interim Order**) from the requirement to be recognized as a clearing agency under subsection 21.2(0.1) of the OSA, until the earlier of (i) September 28, 2024, and (ii) the effective date of a subsequent order exempting JSCC from the requirement to be recognized as a clearing agency under section 147 of the OSA;

AND WHEREAS the Interim Order will be replaced by this Order;

AND WHEREAS JSCC has represented to the Commission that:

- 1.1 JSCC is a joint-stock company formed under the *Companies Act* of Japan on July 1, 2002, and is a majority-owned subsidiary of the Japan Exchange Group, Inc., a publicly traded company listed on the Tokyo Stock Exchange, Inc.
- 1.2 JSCC is licensed as a CCP to perform clearing services ("Financial Instruments Obligation Assumption Services"), including IRS clearing services, under the *Financial Instruments and Exchange Act* (Japan) (**FIEA**). JSCC is obligated under the FIEA to conduct its IRS clearing business in accordance with its IRS Business Rules, which are subject to approval by the Prime Minister of Japan. The IRS Business Rules set out the rights and obligations in relation to the IRS clearing business, including the risk-management framework, to ensure the stable performance of JSCC's clearing operations. The FIEA and Cabinet Office Order on the Regulation of Over-the-Counter Derivatives Transactions requires certain types of IRS and credit default swaps denominated in Japanese yen to be cleared in a licensed clearinghouse. In addition, these laws and regulations require certain over-the-counter (**OTC**) derivative contracts to be reported to (i) trade repositories licensed in Japan or (ii) those incorporated in a foreign jurisdiction and designated by the Prime Minister.
- 1.3 JSCC is regulated and supervised by the Japanese Financial Services Agency (**JFSA**) and is subject to the oversight of the Bank of Japan in respect of its IRS clearing activities. Pursuant to the FIEA, changes to JSCC's articles of incorporation, reductions to its stated capital and the acquisition by any person of 20% or more of the outstanding shares of JSCC are subject to approval by the JFSA. The FIEA also imposes on JSCC a duty of confidentiality and a prohibition on unfairly differential treatment of its clearing participants. The JFSA has the power under the FIEA to take certain actions in respect of JSCC as a regulated CCP, including to conduct inspections, to require reporting, to make business improvement orders and to rescind the CCP's license in certain circumstances. JSCC is also subject to oversight by the Bank of Japan of financial market infrastructures, as provided in the *Bank of Japan Act*.
- 1.4 JSCC is of the opinion that it fully observes the international standards applicable to financial market infrastructures described in the April 2012 report named *Principles for financial market infrastructures* (**PFMIs**) as discussed in its PFMi Disclosure Report dated as of March 31, 2024.
- 1.5 JSCC is recognized by the European Securities and Markets Authority as a Third Country CCP under the European Market Infrastructure Regulation and is subject to an order issued by the U.S. Commodity Futures Trading Commission that exempts JSCC from the requirement to register as a Derivatives Clearing Organization under the U.S. *Commodity Exchange Act*. In Australia, JSCC has received designation as a "prescribed facility" under the Corporations Amendment (Central Clearing and Single Sided Reporting) Regulation 2015. JSCC has obtained from the Hong Kong Securities and Futures Commission authorization to provide Automated Trading Services, as well as designation as a central

counterparty, which can be used for the observance of mandatory clearing obligations under the Securities and Futures Ordinance. JSCC has obtained recognition as a Foreign Central Counterparty under the Financial Market Infrastructure Act from the Swiss Financial Market Supervisory Authority to offer IRS Clearing Services to those trading entities. JSCC has obtained temporary recognition from the Bank of England for the provision of all its clearing services in the U.K. as a Third Country CCP under the *Central Counterparties (Amendment, etc., and Transitional Provision) (EU Exit) Regulations 2018*, to provide services to clearing participants and trading facilities established in the U.K.

- 1.6 Entities that satisfy the participant criteria set forth in JSCC's Interest Rate Swap Clearing Business Rules (**IRS Business Rules**) are eligible to apply for qualification as clearing participants in JSCC's IRS clearing business (**Clearing Participants**). Each Clearing Participant must enter into a Clearing Participant Agreement with JSCC, and the IRS Business Rules are binding on Clearing Participants by virtue of the Clearing Participant Agreement.
- 1.7 JSCC has a single clearing model for IRS and a single category of IRS Clearing Participant. JSCC's participation criteria cover financial integrity, the regulated status of an applicant, and the appropriateness of the applicant's management structure and business execution structure to meet and continue to meet the standards set out by JSCC. The IRS Business Rules impose additional obligations on a Clearing Participant that engages in clearing on behalf of its customers.
- 1.8 JSCC anticipates that banks, pension plans, asset managers, insurance companies and other entities that have a head office or principal place of business in Ontario and that are "local customers" as defined in National Instrument 94-102 *Derivatives: Customer Clearing and Protection of Customer Collateral and Positions (NI 94-102)* may be interested in using JSCC's customer clearing services in respect of certain OTC IRS derivatives (each an **Ontario Customer**). JSCC also anticipates that entities that have a head office or principal place of business in Ontario may be interested in becoming Clearing Participants (each an **Ontario Clearing Participant**) in JSCC's IRS clearing service.
- 1.9 Each Clearing Participant is required to provide JSCC with, and maintain on a daily basis for so long as it is a Clearing Participant, eligible collateral with a collateral value sufficient to satisfy its margin and clearing fund requirements as calculated by JSCC in accordance with the IRS Business Rules.
- 1.10 JSCC will only offer Ontario Customers an individual segregated account structure for client clearing. JSCC segregates each Clearing Participant's proprietary positions and margin from the positions and margin of each customer of the Clearing Participant. The positions and margin of each Ontario Customer will be segregated in individual customer accounts with JSCC at all times, regardless of whether or not the Ontario Customer is an affiliate of the Clearing Participant. A Clearing Participant must deposit the full amount of customer margin with JSCC without delay when it receives margin from a customer unless otherwise agreed by the customer. The IRS Business Rules do not allow for the netting of positions recorded in different customer accounts. JSCC will not permit any Ontario Customer to clear through any "indirect intermediary" as defined in NI 94-102 or permit any Ontario Customer to on-board any indirect client that would clear through the Ontario Customer.
- 1.11 The IRS Business Rules (including in particular the default procedures contained within them) govern the processes that apply to Clearing Participants in the case of a Clearing Participant default. Clearing Participants remain responsible for the credit risk of their customers. JSCC has established a financial safeguards system to provide optimal risk management protections including the establishment of a segregated financial safeguard waterfall for cleared IRS that is designed to ensure that JSCC has sufficient resources to cover defaulting Clearing Participant losses in a wide range of potential stress scenarios including the extreme scenario where the two largest Clearing Participants (including any affiliated entities) default at the same time.
- 1.12 Upon the default of a Clearing Participant, JSCC will take action to contain losses by halting clearing of new transactions from the defaulter and liquidating the defaulter's positions. JSCC's methods for disposing of positions vary according to the nature of the product cleared. For JSCC's IRS clearing business, an auction involving non-defaulting Clearing Participants is used. In addition, hedge transactions may be promptly executed for the defaulter's portfolio to minimize the risk of losses prior to the disposal of the defaulter's positions. For the IRS clearing business, hedge transactions are executed based on the advice of the IRS Default Management Committee.
- 1.13 A Clearing Participant must successfully complete simulated default tests to demonstrate they have the appropriate expertise and operational processes in place prior to beginning clearing operations. Once live, all Clearing Participants are required to participate in fire drills regularly to confirm their operational readiness to manage a Clearing Participant default.
- 1.14 JSCC currently offers portfolio margining (also known as cross-margining) of (a) cleared IRS, (b) certain Japanese Government Bond futures contracts (**JGB Futures**), and (c) certain Japanese interest rate futures contracts (together with JGB Futures, the **Cross-Margined Instruments**), in each case, in customer accounts in accordance with the IRS Business Rules (the **Cross-Margining Service**). JSCC proposes to make its Cross-Margining Service available to Ontario Clearing Participants and Ontario Customers that use JSCC's IRS clearing services and the applicable clearing services for Cross-Margined Instruments.

- 1.15 By combining positions in both IRS and Cross-Margined Instruments into a single portfolio for margin purposes, JSCC's Cross-Margining Service allows the overall risk of that portfolio to be determined. Because IRS and Cross-Margined Instruments experience pricing changes that are correlated with variations in Japanese yen interest rates, which may result in offsetting changes in the aggregate potential future exposure of a portfolio of positions, cross-margining can result in a margin requirement that is more proportionate to the aggregate risk of the portfolio. Thus, the benefit of JSCC's cross-margining of IRS and Cross-Margined Instruments for Ontario Customers and Ontario Clearing Participants, through the margin savings on the same basis as is available to entities outside Ontario, may be significant.
- 1.16 Pursuant to the Interim Order, the Commission exempted JSCC on an interim basis from the requirement to be recognized as a clearing agency under section 21.2 of the OSA with the condition that JSCC's activities in Ontario would be limited to providing customer clearing services for IRS transactions for and on behalf of Ontario Customers clearing IRS transactions through a Clearing Participant that is resident outside of Ontario and is a "clearing intermediary" that is a "direct intermediary" as defined in NI 94-102. JSCC applied for the Interim Order to permit a bank listed in Schedule I of the *Bank Act* (Canada) (Schedule I Bank) to clear IRS transactions through a Clearing Participant resident outside of Ontario.
- 1.17 JSCC would provide its services to Ontario Customers and Ontario Clearing Participants without establishing an office or having a physical presence or employees in Ontario or elsewhere in Canada.
- 1.18 JSCC submits that it does not pose a significant risk to the Ontario capital markets and is subject to an appropriate regulatory and oversight regime in a foreign jurisdiction.

AND WHEREAS JSCC has agreed to the terms and conditions as set out in Schedule "A" to this order;

AND WHEREAS JSCC is required to comply with National Instrument 24-102 *Clearing Agency Requirements*;

AND WHEREAS based on the Application and the representations that JSCC has made to the Commission, in the Commission's opinion the granting of the Order to exempt JSCC from the requirement to be recognized as a clearing agency would not be prejudicial to the public interest;

AND WHEREAS JSCC has acknowledged to the Commission that the scope of and the terms and conditions imposed by the Commission attached hereto as Schedule "A" to this Order, or the determination whether it is appropriate that JSCC continue to be exempted from the requirement to be recognized as a clearing agency, may change as a result of the Commission's monitoring of developments in international and domestic capital markets, JSCC's activities, or as a result of any changes to the laws in Japan or Ontario affecting trading in or clearing and settlement of derivatives or securities;

IT IS HEREBY ORDERED by the Commission that pursuant to section 147 of the OSA, JSCC is exempt from the requirement to be recognized as a clearing agency under subsection 21.2(0.1) of the OSA;

PROVIDED THAT JSCC complies with the terms and conditions attached hereto as Schedule "A".

DATED this [•] day of [•], 2024.

[Name]

[Title]

Ontario Securities Commission

SCHEDULE “A”

Terms and Conditions

Unless the context requires otherwise, the terms used in this Schedule “A” have the meanings ascribed to them in Ontario securities law (including terms defined elsewhere in this order).

COMPLIANCE WITH ONTARIO LAW

1. JSCC must comply with Ontario securities law (as defined in the OSA).
2. JSCC’s IRS clearing services must comply with National Instrument 94-102 *Derivatives: Customer Clearing and Protection of Customer Collateral and Positions (NI 94-102)*, except where and to the extent that JSCC has obtained an order exempting JSCC from the requirements of NI 94-102 and complies with the terms of such order.

SCOPE OF PERMITTED CLEARING SERVICES IN ONTARIO

3. JSCC’s activities in Ontario will be limited to providing CCP clearing services for IRS transactions for and on behalf of Ontario Clearing Participants and Ontario Customers (**Permitted Clearing Services**).
4. Prior to first admitting a Clearing Participant that is an Ontario-resident entity, JSCC shall obtain a legal opinion that confirms the closeout netting and collateral enforcement provisions of the IRS Business Rules are effective in respect of such proposed Ontario-resident Clearing Participant under applicable laws of Ontario and the federal laws of Canada applicable therein.

REGULATION OF JSCC

5. JSCC must maintain its license as a CCP to perform clearing services in Japan (“Financial Instruments Obligation Assumption Services”), including IRS clearing services under the FIEA. JSCC is regulated and supervised by the JFSA and is subject to the oversight of the Bank of Japan in respect of its IRS clearing activities and will continue to be subject to the regulatory oversight of the JFSA and the Bank of Japan or any successors.
6. JSCC must continue to comply with its ongoing regulatory requirements as an entity licensed to perform IRS clearing services under the FIEA or any comparable successor legislation, and with the ongoing regulatory requirements of the JFSA, as applicable. For so long as JSCC maintains its existing licenses, authorizations, and recognition or exemption orders in certain jurisdictions outside Japan as described in representation 1.5 above, JSCC must continue to comply with its ongoing regulatory requirements as a CCP in such jurisdictions pursuant to such licenses, authorizations, and recognition or exemption orders.

GOVERNANCE

7. JSCC must promote within JSCC a governance structure that minimizes the potential for any conflict of interest between JSCC and its shareholders that could adversely affect the Permitted Clearing Services or the effectiveness of JSCC’s risk management policies, controls and standards.

REPORTING REQUIREMENTS

Reporting with JFSA

8. JSCC must promptly provide staff of the Commission with the following information, to the extent that it is required to provide or submit such information to JFSA or any successor:
 - (a) details of any material legal proceeding instituted against JSCC;
 - (b) notification that JSCC has failed to comply with an undisputed obligation to pay money or deliver property to an Ontario Clearing Participant or an Ontario Customer for a period of thirty days after receiving notice from the applicable Clearing Participant of JSCC’s past due obligation;
 - (c) notification that JSCC has instituted a petition for a judgment of bankruptcy or insolvency or similar relief, or to wind up or liquidate JSCC or has a proceeding for any such petition instituted against it;
 - (d) notification that JSCC has initiated its recovery plan;
 - (e) the appointment of a receiver or the making of any voluntary arrangement with creditors;
 - (f) the entering of JSCC into any resolution regime or the placing of JSCC into resolution by a resolution authority;

- (g) material changes to the IRS Business Rules where such changes would impact the Permitted Clearing Services used by Ontario Clearing Participants or Ontario Customers;
- (h) new services or clearing of new types of products in the Permitted Clearing Services to be offered to Ontario Clearing Participants or Ontario Customers or services or types of products that will no longer be available to Ontario Clearing Participants or Ontario Customers; and
- (i) any new category of membership in respect of the Permitted Clearing Services if JSCC expects that category of membership would be available to Ontario Clearing Participants or Ontario Customers;

Financial Statements

- 9. JSCC must promptly provide staff of the Commission with the following information:
 - (a) English translations of interim financial statements, if available; and
 - (b) English translations of annual audited financial statements, within 30 days of providing the Japanese version of any such statements to the JFSA.

Prompt Notice

- 10. JSCC must promptly notify staff of the Commission of any of the following:
 - (a) any material change to its business or operations;
 - (b) any material change or proposed material change in JSCC's status as an entity licensed to perform "Financial Instruments Obligation Assumption Services" under the FIEA or in its regulation and supervision by JFSA or any successor;
 - (c) any material problems with the clearing and settlement of transactions that could materially affect the safety and soundness of JSCC;
 - (d) the admission of any new Ontario Clearing Participant or Ontario Customer;
 - (e) any event of default by, or removal from Permitted Clearing Services of, an Ontario Clearing Participant or an Ontario Customer;
 - (f) any material system failure of a Permitted Clearing Service used by an Ontario Clearing Participant or an Ontario Customer, including cybersecurity breaches; and
 - (g) any default by a Clearing Participant clearing Cross-Margined Instruments on behalf of an Ontario Clearing Participant that uses the Cross-Margining Service.

Quarterly Reporting

- 11. JSCC must maintain and submit the following information to the Commission in a manner and form acceptable to the Commission on a quarterly basis within 30 days of the end of each calendar quarter, and at any time promptly upon the request of staff of the Commission:
 - (a) a current list of all Ontario Clearing Participants and Ontario Customers and the legal entity identifier (**LEI**), if any, of each such Ontario Clearing Participant and Ontario Customer;
 - (b) a list of all Ontario Clearing Participants and Ontario Customers against whom disciplinary or legal action has been taken in the quarter by JSCC with respect to activities at JSCC, or to the best of JSCC's knowledge, by JFSA or any other authority in Japan that has or may have jurisdiction with respect to the relevant Ontario Clearing Participant or Ontario Customer's clearing activities at JSCC, provided that the Commission will maintain the confidentiality of the identity of any such Ontario Clearing Participant and Ontario Customer, unless (i) required by a court of competent jurisdiction, law, regulation or memorandum of understanding with a regulatory authority to release such identity, (ii) disclosure is permitted by or consistent with the purposes of the OSA, or (iii) such identity is publicly available;
 - (c) a list of all investigations by JSCC in the quarter relating to Ontario Clearing Participants and Ontario Customers, provided that the Commission will maintain the confidentiality of the identity of any such Ontario Clearing Participant and Ontario Customer, unless (i) required by a court of competent jurisdiction, law, regulation or memorandum of understanding with a regulatory authority to release such identity, (ii) disclosure is permitted by or consistent with the purposes of the OSA, or (iii) such identity is publicly available;

- (d) quantitative information in respect of the Permitted Clearing Services used by the Ontario Clearing Participants and Ontario Customers broken down by each Clearing Participant (identified by LEI) that (i) is an Ontario Clearing Participant, or (ii) is not an Ontario Clearing Participant but provides the Permitted Clearing Services to an Ontario Customer, if applicable, including the following:
 - i. the end of quarter level, maximum and average daily open interest, number of transactions and notional value of transactions cleared during the quarter for each Ontario Clearing Participant and Ontario Customer, by product type;
 - ii. the percentage of end of quarter level and average daily open interest, number of transactions and the notional value cleared during the quarter for all Clearing Participants that represents the end of quarter and average daily open interest, number of transactions and the notional value of transactions cleared during the quarter for each Ontario Clearing Participant and Ontario Customer, by product type;
 - iii. the aggregate total margin amount required by JSCC on the last trading day during the quarter for each Ontario Clearing Participant and Ontario Customer; and
 - iv. the percentage of the total margin required by JSCC, on the last trading day of the quarter, for all Clearing Participants that represents the total margin required for each Ontario Clearing Participant and Ontario Customer;
- (e) the IRS clearing fund contribution, for each Ontario Clearing Participant on the last trading day of the quarter, and its proportion to the total IRS clearing fund contributions;
- (f) the percentage of IRS positions, in terms of notional value and number, held by each Ontario Clearing Participant that are cross-margined as of the last trading day of the quarter;
- (g) the notional value and number of Cross-Margined Instruments positions that are cross-margined via JSCC's Cross-Margining Service with the IRS positions held by each Ontario Clearing Participant as of the last trading day of the quarter; and
- (h) a summary of risk management analysis related to the adequacy of the required margin and the IRS clearing fund requirement, including but not limited to stress testing and backtesting results.

INFORMATION SHARING

- 12. JSCC must promptly provide such information as may be requested from time to time by, and otherwise cooperate with, the Commission or its staff, subject to any applicable privacy or other laws that would prevent the sharing of such information and subject to the application of solicitor-client privilege.
- 13. Unless otherwise prohibited under applicable law, JSCC must share information relating to regulatory and enforcement matters and otherwise cooperate with other recognized and exempt clearing agencies on such matters, as appropriate.