Tokyo Foreign Exchange Market Committee
T+1 Subcommittee

Report on the T+1 Settlement Issue

- The Impact of the Introduction of T+1 Settlement in the U.S. Equity Market on the Japanese Foreign Exchange Market -

This Report has been prepared by the initiative of the T+1 Subcommittee of the Tokyo Foreign Exchange Market Committee. From April in 2001 to March in 2002, the Subcommittee held discussions to gauge the level of awareness and the status of initiatives taken in Japan vis-à-vis the introduction of T+1 settlement in the U.S. equity market and its potential impact on the Tokyo foreign exchange market.

Meanwhile, in July this year SIA (The Securities Industry Association) in the U.S. decided to replace the STP/T+1 program to convert from T+3 to T+1 settlement by 2005 with straight-through processing goals to be accomplished over the next two years. The conversion of settlement period from T+3 to T+1 seems to be evaluated again in 2004.

Introduction

This Report has been prepared by the initiative of the T+1 Subcommittee of the Tokyo Foreign Exchange Market Committee. The Subcommittee held discussions on the following matters to gauge the level of awareness and the status of initiatives taken in Japan vis-à-vis the introduction of T+1 settlement [in the U.S. equity market] and its potential impact on the Tokyo foreign exchange ("FX") market. The parties concerned are expected to become more active in responding to the change going forward. We will continue to monitor developments, and plan to further discuss the measures that should be taken, including the need for cooperating with the bodies concerned. The Subcommittee exchanged information with the Japan Securities Dealers Association and the Investment Trust Association, Japan in preparing this Report. The latter, in particular, provided us with a great deal of assistance with the questionnaire survey. We would like to take this opportunity to thank the two associations.

- The level of awareness among and the status of initiatives taken by Japanese investors (Results of the questionnaire survey)
- The relationship among investment managers (and/or external investment advisor/sub-manager), trustees (trust banks) and FX banks
- The need for a "central trade reconciliation system" among the three players listed above
- Dollar/yen trades relating to the settlement of U.S. equity trades
- Time constraint on yen settlements under T+1
- The possible loss of FX business from the Tokyo foreign exchange market

Summary

(1) An examination of the initiatives taken by Japanese institutional investors to respond to the introduction of T+1 settlement in the U.S. equity market reveal that many are highly aware of the migration but that many have yet to begin examining specific responses.

(2) Tokyo will be required to process back office workflow in a quite short period of time once T+1 is introduced owing to the time difference. Consequently, it is likely that investment managers, trust banks and FX banks (N.B.) will be required to automate the trade settlement process on a large-scale by such means as establishing an STP network among themselves.

(3) Another potential impact on the Tokyo FX market is that FX trades associated with U.S. equity trades are likely to flow out to overseas markets. The possibility of this occurring is the highest when the aforementioned effort to automate the trade settlement process is delayed or when operational risks in this country are deemed to increase.

(4) Liquidity will be one of the most important issues to remain in the event smooth progress is made in automating the settlement process and the necessary back office organization established. FX trades resulting from trades in U.S. equities are likely to take place either in the late hours in the New York market or the early hours in the Tokyo market once T+1 is introduced. Whether there will be sufficient liquidity in the early hours of Tokyo will be an important factor that will determine where cover trades will be executed. It is, therefore, necessary to monitor market developments post T+1.

(N.B.) The term will be used to refer to counter-parties to FX trades, such as banks, investment banks and securities companies.

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1. Background

The reduction of settlement risk pertaining to financial transactions has become a major issue in recent years in the developed nations. The shortening of the settlement period (the period between the trade date and the settlement date) is a representative means of reducing this risk along with delivery versus payment (DVP) (N.B.1). In the fixed income markets, U.S. Treasuries and Agencies are already settled on a T+1 basis and efforts are currently underway to shorten the settlement period for U.S. equity trades from T+3 to T+1. The plan as of the end of 2001 was to implement the change in June 2005 (N.B.2).

(N.B.1) The intent behind shortening the settlement period is to reduce the outstanding balances pending settlement to contain the impact of default. The approach differs from DVP, which focuses on mitigating the risk of non-collection.

(N.B.2) The plan calls for the parallel existence of T+3 and T+1 settlements for a year beginning in June 2004 on a trial basis and a full migration to T+1 after a year. The timing of the migration has been delayed by a year owing to the September 11 terrorist attacks on the U.S.

Japanese investors are active investors in U.S. equities. In many cases they buy dollars when purchasing equities, and sell dollars and convert the amount back into yen when disposing their holdings. As spot FX trades are settled on a T+2 basis, they are likely to be affected substantially when U.S. equity trades migrate to T+1 settlement.

- Some markets, such as the U.S. Treasury and U.S. Agency markets, have already adopted T+1 settlement. U.S. Treasuries may be traded during Tokyo time and the settlement date may be determined freely, as the trades are conducted over-the-counter. This is why the difference in the settlements period between the U.S. fixed income and the FX markets did not present problems. However, since U.S. equities are traded through the exchange and settlement dates cannot be determined freely, the FX issue will emerge as a problem.

It is against this background that the Tokyo Foreign Exchange Market Committee established the T+1 Subcommittee in April 2001 to examine the impact of this migration on the Tokyo FX market.

- Early last year, the Tokyo Foreign Exchange Market Committee was informed by the New York FX Market Committee that the Securities Industries Association had established a subcommittee to examine the impact of the T+1 migration in the U.S. equity market on FX trades ("U.S. Subcommittee"). We were invited to participate in the examination with them. This Subcommittee embarked on its research efforts while exchanging information on the status of its examination with the U.S. Subcommittee via the New York FX Market Committee. (Cf. Attachment 1 Subcommittee Membership)

- The scope of work undertaken by this Subcommittee is the potential impact of the migration to T+1 settlement on the Tokyo FX market and FX trades conducted in this market. Therefore, the Report does not examine the issue of shortening the settlement period for spot FX trades in general, although we are aware that this is a matter that requires separate examination going forward.

2. Where the problems lie

The SIA views the migration to T+1 not only as a way of shortening the settlement period, but as an opportunity to construct a sophisticated network-based back office system that supports efficient trade processing by organically linking trades and all the parties concerned by advanced electronic means of communication.

- The SIA estimates that it would cost the U.S. securities industry some 8 billion dollars to build such a system, but expects to be able to collect on the investment in three years' time supported by the increased efficiency of back office operations.

Meanwhile, Japan lags behind the U.S. substantially in conducting a similar examination. The findings of the survey of the investment trust management companies and investment advisors (cf. Attachment 5 for details) indicate that while they are highly aware of the planned migration to T+1 in the U.S. equity market, actual efforts to consider measures have hardly began at the individual company level. Consequently, no industry-wide efforts or those involving related industries have been initiated to build a system to support this migration and remains a task to be tackled going forward..

The Report aims to summarize the findings of the survey regarding the awareness about T+1 migration and the initiatives that are being taken. It also aims to use this and the discussions held internally within the Subcommittee to point out future challenges.

In the following pages, we will present the findings of the survey, and provide an overview of how Japanese investors are settling and conducting FX trades regarding U.S. equities. We will then examine the options available to those investors in conducting FX trades post T+1, and finally how the change in their FX trading activities may affect the Tokyo FX market.

3. Level of awareness among and the status of initiatives taken by Japanese investors regarding T+1

The Subcommittee conducted a survey of the Japanese fund managers in August 2001 to gauge the level of their awareness regarding the introduction of T+1 in the U.S. equity market and the initiatives they may be taking.

- A total of 79 investment trust managers and investment advisers were surveyed. The response ratio was low, at less than 30%, but the responses offered us an instructive and interesting insight into the current status of things.

Firstly, the results indicated that investors are highly aware of the migration to T+1.

However, only a very limited few have began considering measures to respond to this change, and consequently, even fewer investors have embarked on developing the necessary systems.

The status of progress in Japan greatly lags behind that of the U.S. In the U.S., the SIA has taken the initiative to lead the related industries to identify the new back office workflow and the systems that are required to support the new business practice, and thus, to examine the matter in substantially concrete terms. It cannot be helped that Japan lags behind the U.S., as it is not the principal initiating the migration, but it will be required to respond in a similar fashion once the migration is effected. It is hoped that efforts will be made to consider the matter in every aspect including the required back office and risk management setup quickly so that this country is able to catch up with the progress made in the U.S.

- However, we should note that some institutional investors have begun to tackle the T+1 issue on a full-fledged basis more recently.

4. Current status of U.S. Equity investments

The "Status of Overseas Investments by Major Markets" provided by the Ministry of Finance (cf. Attachment 2) indicate that the amount of U.S. equities traded by residents of Japan exceed \20 trillion a year.

It is not clear as to how much of this involves FX trades, but a substantial portion is likely to be accompanied by FX trades.

Currently, there are two ways in which yen-based managers of funds ("tokkin" funds and investment trusts) in Japan that invest in U.S. equities (fund managers in investment advisory firms and investment trust management firms) execute FX trades: (1) They execute FX trades directly with FX banks at their own discretion, and (2) they instruct external investment advisors (sub-managers), who are mandated to manage funds with discretion, execute FX trades with FX banks on their behalf. In either case, the trades are confirmed and settled by trust banks. As indicated above, asset managers (external managers), trust banks and FX banks are involved in the execution of FX trades when Japanese investors buy or sell U.S. equities.

The flow that begins with the Japanese institutional investor placing orders to buy U.S. equities and ends with settlement of FX trades (cf. flow chart in Attachment 3) may be classified into the following three types:

(1) Japanese investment manager executes FX trades with FX bank in Japan after trading U.S. equities
(2) External investment manager based in the U.S. executes FX trades directly with FX bank in the U.S. after trading U.S. equities
(3) Japanese investment manager executes FX trades with FX bank in Japan after

the external investment advisor based in the U.S. trades U.S. equities.

- In case of (2), the FX bank in the U.S. normally uses its branch in Japan to process the related back office work with the trust bank (commonly referred to as "back-to-back" processing) as shown on 3(2)-(A) on Attachment 3. If it does not have a branch in Japan, it will directly confirm and book the underlying trade with the trust bank while outsourcing the work of the payment and the receipt of the yen to a correspondent bank (ditto (2)-(B)).

As indicated above, there are already cases where the FX trades associated with U.S. equity investments are executed in the U.S. market. In the case of (1) and (3) where the FX trades are effected in Japan, the trades are effected on the day following the U.S. equity trades (the day that is equivalent to T+1).

The matter of how the aforementioned FX trades currently executed in the Tokyo market will be affected once T+1 settlement is introduced in the U.S. equity market is a material issue for the Tokyo market.

5. Options available to investment managers post T+1

In this section we will examine the options that are available to investors regarding FX trades, the pros and cons, and feasibility post T+1 settlement.

Broadly speaking, there are two ways of procuring dollars when Japanese investors buy U.S. equities. One is to procure dollars beforehand and leave the amount in an U.S. bank account ("pre-funded") and the other is to procure dollars every time they buy U.S. equities ("not pre-funded"). In case they opt not to hold dollars in an account they may theoretically resort to the following three means of procuring dollars depending on the time of procurement:

a) U.S. T+1
b) Tokyo T+0
c) U.S. T+0

(1) Pre-funded (Trade FX independently of securities trades)

In this instance, the investor would conduct FX trades independently of securities trades and pre-fund dollars for future U.S. equities purchases in their U.S. custody accounts, while accumulating and investing dollar proceeds from the sale of U.S. equities.

- This method does not pose major problems from the perspective of investment efficiency, as most U.S. custodians offers cash management service on such idle dollar cash.

This method will be free of any additional time constraints on back office administration among the three parties involved, and investors may continue to trade FX in the same manner without experiencing any settlement problems. Whether this method will become the primary means of procuring dollars is dependent on whether Japanese investors will change the way in which they manage their assets.

- Since 2001, pension fund accounting has shifted from accounting on the basis of book value at delivery to marking to market on the trade date. However, many pension fund sponsors (end investors) continue to require yen-based accounting treatment and evaluating investment performance by asset classes that does not assume surplus foreign cash as an asset class, and thus, shy away from pre-funding dollars. Moreover, in the case of investment trusts, managers need to maintain surplus funds in yen rather than manage it in dollars to ensure that they have sufficient cash to meet unexpected redemption needs.

(2) Not pre-funded (Trade FX each time a securities trade is conducted)
In this case, investors theoretically have three options. a) Procure dollars in the U.S. on a T+1 basis, b) procure dollars in Tokyo on a T+0 basis, and c) procure dollars in the U.S. market on a T+0 basis after the U.S. market closes and before the Tokyo market opens (N.B.)

(N.B.) Some point out that it would be possible to trade FX in the Tokyo market after T+1 by concluding an agreement to extend settlement beyond T+1 when trading U.S. equities. However, brokers involved in this trade may be deemed to be lending against assets under management. It also goes against the original objective of migrating to T+1 settlement. We believe that this will not be a feasible option for investors other than for some extreme cases.

When we compare the feasibility of the aforementioned options, we see many problems with option (b) as indicated below. Even if investors do not opt to pre-fund dollars, there is strong likelihood that FX trades accompanying the purchase or the sale of U.S. equities will shift to the U.S. market.

- If investors opt for T+0 in the Tokyo market, the time they will have [to process back office workflow] after the FX trade will be shorter than if they opt for T+1 in the U.S. market. This could potentially increase the operational risk among the three parties involved.

- Investors must also inform the party to which they outsource the FX trade (or the party directly placing the FX order) the exact amount of dollars that needs to be bought or sold in the Tokyo market. This may lead to increased operational risk arising from omissions of information that should be communicated or errors in the amount communicated. The same risk will apply to T+0 in the U.S. market, if different parties are responsible for buying equities and procuring dollars.

- FX trades accompanying U.S. equity trades are likely to be conducted as quickly as possible after the New York market closes (16:00 EST) when the consideration will be determined. This boils down to comparing the liquidity available in the early evening of the New York market (for both T+1, T+0) and the early hours of the Tokyo market (for T+0 trades). (FX trades are likely to be conducted in the very early hours in Tokyo due to the time constraint). Currently, liquidity is likely to be a problem in either market during the said hours. It is difficult to forecast which market will offer higher liquidity post T+1. How FX banks may approach this issue will be an important factor that will determine the liquidity that will be made available.

- Investors may prefer to trade with Japanese dealers, but this issue is likely to be resolved (i.e., foreign dealers will probably employ Japanese staff to act as advisors or contact persons).

○ Of the FX trades accompanying U.S. equity trades, FX trades executed in the U.S. market for T+0 settlement are likely to be limited to exceptional cases where equities are traded during very late hours. (Only a few investment trust managers surveyed by this Subcommittee indicated that they would look to conduct T+0 trades in the U.S. market, even if they are likely to conduct FX trades after they trade U.S. equities.) It is, therefore, likely that any FX trades accompanying U.S. equity trades executed in the U.S. market will be settled on a U.S. T+1 basis. (N.B.)

(N.B.) In case of U.S. T+1, theoretically we can envisage 3 methods depending on who will actually execute the FX trades (cf. Attachment 4 for details).

6. Issues relating to FX trades after trading U.S. equities

○ The following three points must be noted regardless of whether FX trades accompanying U.S. equity trades will be conducted on a U.S. T+1 basis or on a Tokyo T+0 basis.

(1) The whole back office process must be completed within 6-7 hours after the closing of the U.S. equity market (T+0 in the U.S., 16:00 EST) until the deadline on yen fund remittance (T+1 in Tokyo, 12:00 JST).

- Orders to trade dollars would be placed after the consideration for the securities trade is determined. The back office workflow beginning with the confirmation of the securities trade to issuing settlement instructions, and placing FX orders to transmitting settlement instructions must be completed within 6-7 hours.

(2) Reasonable liquidity in the FX market is a major pre-requisite to facilitating the above workflow. The introduction of STP supported by a “central reconciliation system” and other such systems that links the three parties: investment advisors (investment manager), FX banks and trust banks (trustees) would have to be constructed in the FX business arena to ensure that the whole workflow would be completed accurately within the limited time frame. The system would be something similar to the TFM being built by GSTPA or the CTM being built by Omgeo to support T+1 securities trades. However, the parties involved have yet to embark on the effort to commence examination.

(3) Japanese “tokkin”(custody) funds and investment trusts manage idle yen cash in the overnight “call loan” market in Tokyo. Most of these trades are completed before lunchtime. In another words, the asset managers may be forced to manage the cash at less attractive terms or find themselves unable to invest anywhere, if they are unable to determine the exact amount that they are to manage in this overnight call loan market by 9:00 in the morning. The parties involved (asset managers, trustees and FX banks) may be forced to come into the office very early in the morning to determine the amount that are to be managed in the overnight call loan market by 9:00AM.

7. Impact on the Tokyo FX market (Loss of FX business to overseas markets)

As we have outlined above, it is likely that FX trades will be lost to overseas markets when the U.S. equity market migrates to T+1 settlement, regardless of whether the FX trade is executed before or after the equity trade. This loss of FX business relating to the trading of U.S. equities may very well lead to changes in the trading relationships and ultimately to the loss of other FX businesses to overseas markets.

Should volume and liquidity in the Tokyo FX market dwindle as a result of the aforementioned developments, it could further impact the consolidation already witnessed among foreign banks and investment advisors with further relocation of offices to overseas markets.

This would be the result of streamlining operations, and thus, should not be regarded as being problematic in itself, but counter-measures should be considered from the perspective of revitalizing the Tokyo FX market.

More specifically, initiatives must be taken at the earliest possible time not only within individual companies, but also involving related parties to examine the possibility of introducing the required automation and establishing the necessary communications infrastructure to respond to T+1 migration in the U.S. equity market. This is to ensure smooth execution of FX trades in the Tokyo market. We believe that explaining the issue at hand and the counter-measures that are being contemplated to clients at an early stage will help prevent investors from departing from the Tokyo market. Finally, as the matter is likely to have significant impact on a broad base of parties concerned and market practice, we expect each individual market participant to focus on the issues. We also believe that the industry needs to take the necessary initiatives and that there should be collaboration among the related industries.

8. Introduction of T+1 settlement in the Japanese securities market

We have asked around about the issue of introducing T+1 settlement in the Japanese securities market and have found that plans are in place to migrate to T+1 in both the fixed income and equity markets. One of the primary groups that are tackling the issue is Japan Securities Dealers Association. We would like to examine the impact of T+1 migration in Japan on the Tokyo FX market going forward.

9. Attachments

Attachment 1

Tokyo Foreign Exchange Market Committee
T+1 Subcommittee

Chairman of the Subcommittee: Kazunari Kobayashi (State Street Bank & Trust Company)
Hiroshi Kitajima (ditto)
Masayasu Suzuki (Nomura Securities)
Keiko Tamaki (Goldman Sachs Asset Management)
Hirochika Nishikawa (Bank of Japan)
Kenichi Makino (Mitsubishi Trust and Banking Co.)

Attachment 2

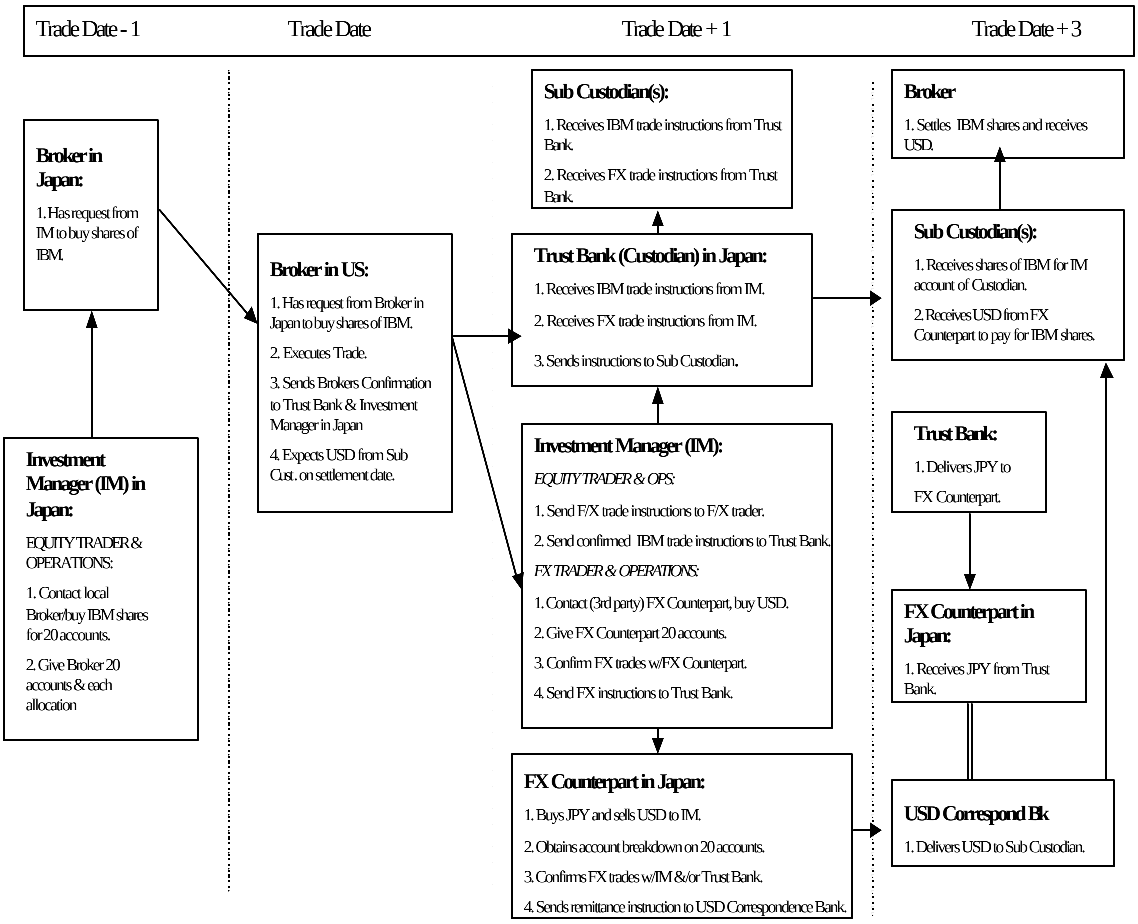
Status of investments in U.S. equities – settlement basis (Source: Ministry of Finance)

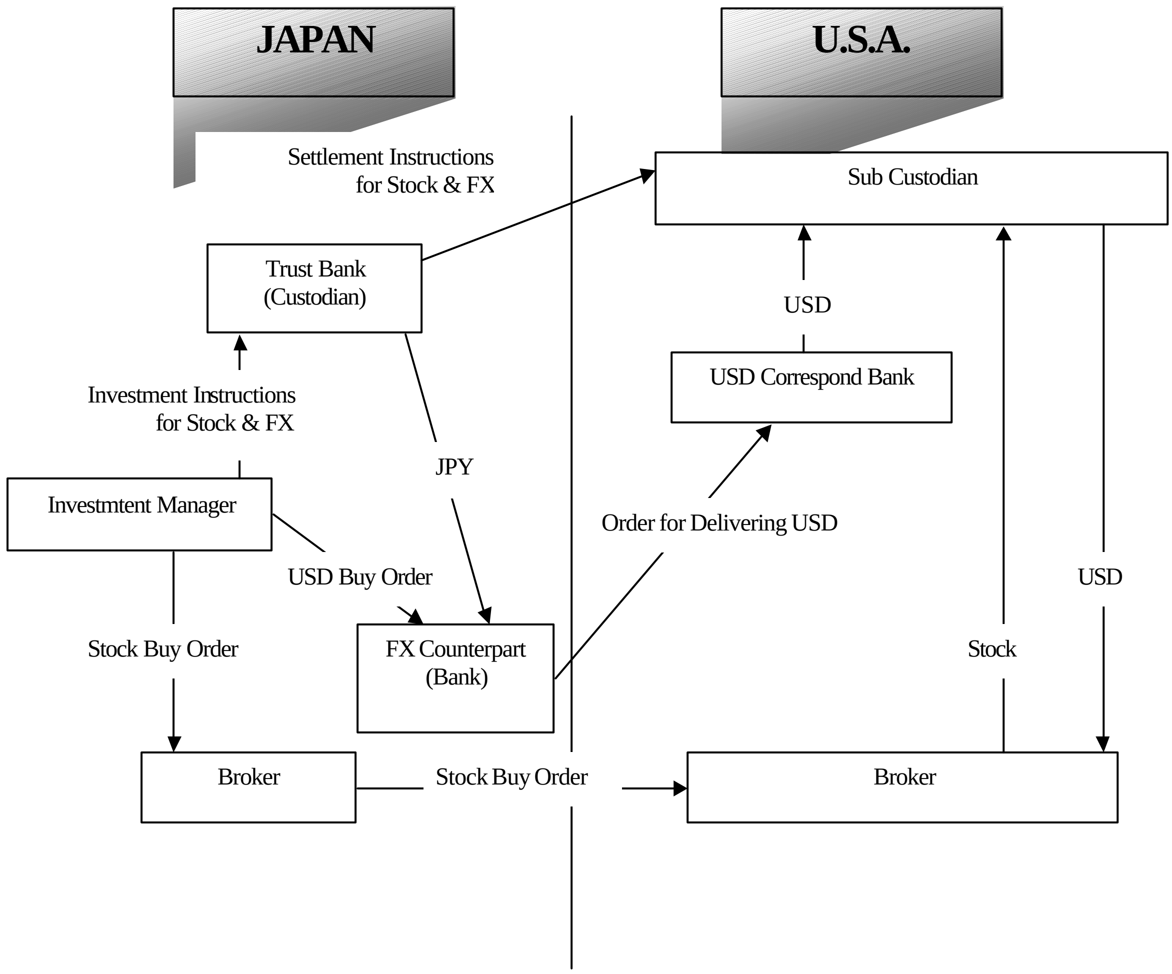
Status of U.S. equity investments

(Unit: \100 million)

		Bought	Sold	Net
1999		108,506	93,884	14,622
2000		126,345	115,007	11,339
2001	January	8,194	8,778	△ 584
	February	7,377	8,069	△ 692
	March	8,071	7,742	329
	April	10,207	7,840	2,367
	May	9,281	6,968	2,313
	June	10,164	8,245	1,920
	July	9,366	6,115	3,251
	August	8,023	7,061	962
	September	6,869	6,789	79
	October	12,087	8,751	3,336
	November	7,029	6,870	159
	December	11,166	9,608	1,558
	Subtotal	96,668	83,228	13,440

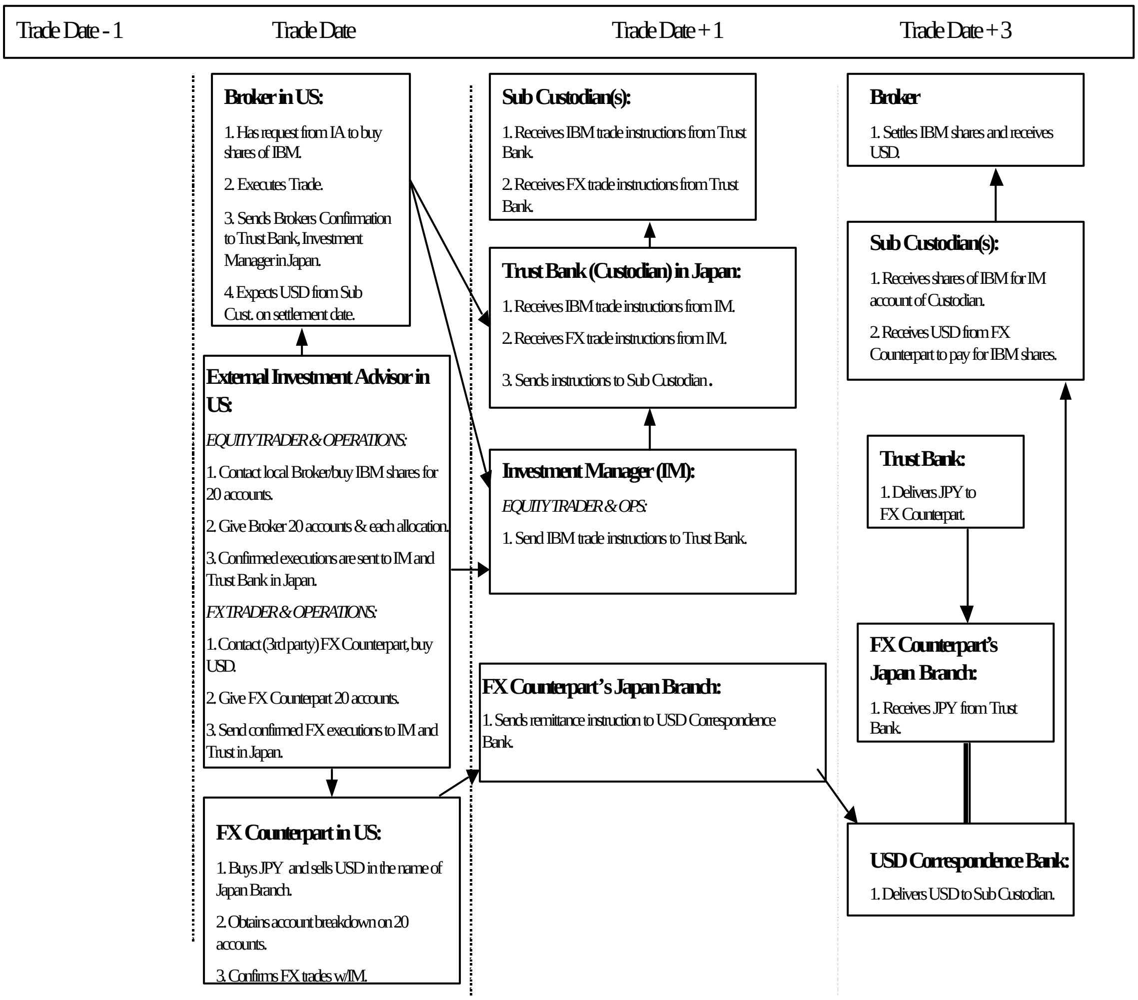
(1) Investment Manager in Japan Does Both U.S. Equity and FX Trading

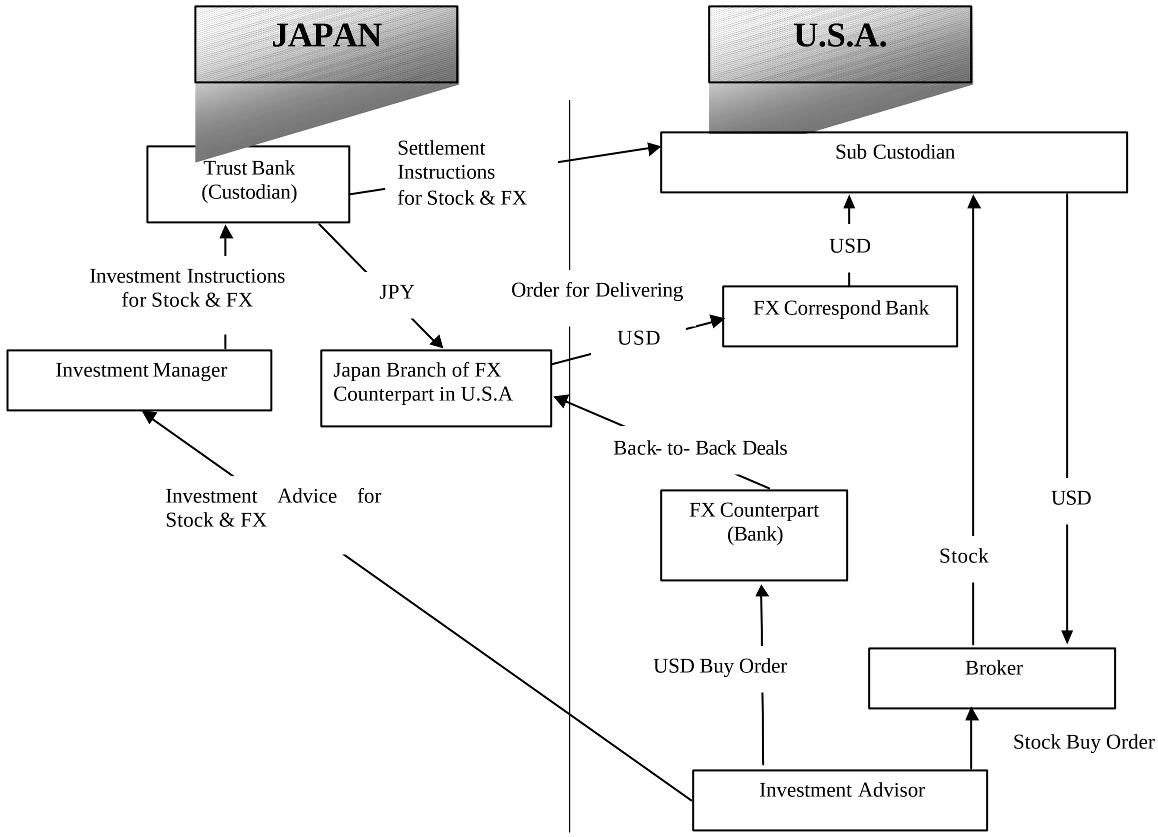




JAPAN
U.S.A.
Settlement Instructions
for Stock & FX
Sub Custodian
Trust Bank
(Custodian)
USD
USD Correspond Bank
Investment Instructions
for Stock & FX
JPY
Investmtent Manager
Order for Delivering USD
USD Buy Order
USD
Stock Buy Order
FX Counterpart
(Bank)
Stock
Broker
Stock Buy Order
Broker

(2)-(A) External Investment Advisor in U.S. Does Both U.S. Equity and FX Trading

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FX Correspond Bank
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Back- to- Back Deals
Investment Advice for Stock & FX
FX Counterpart (Bank)
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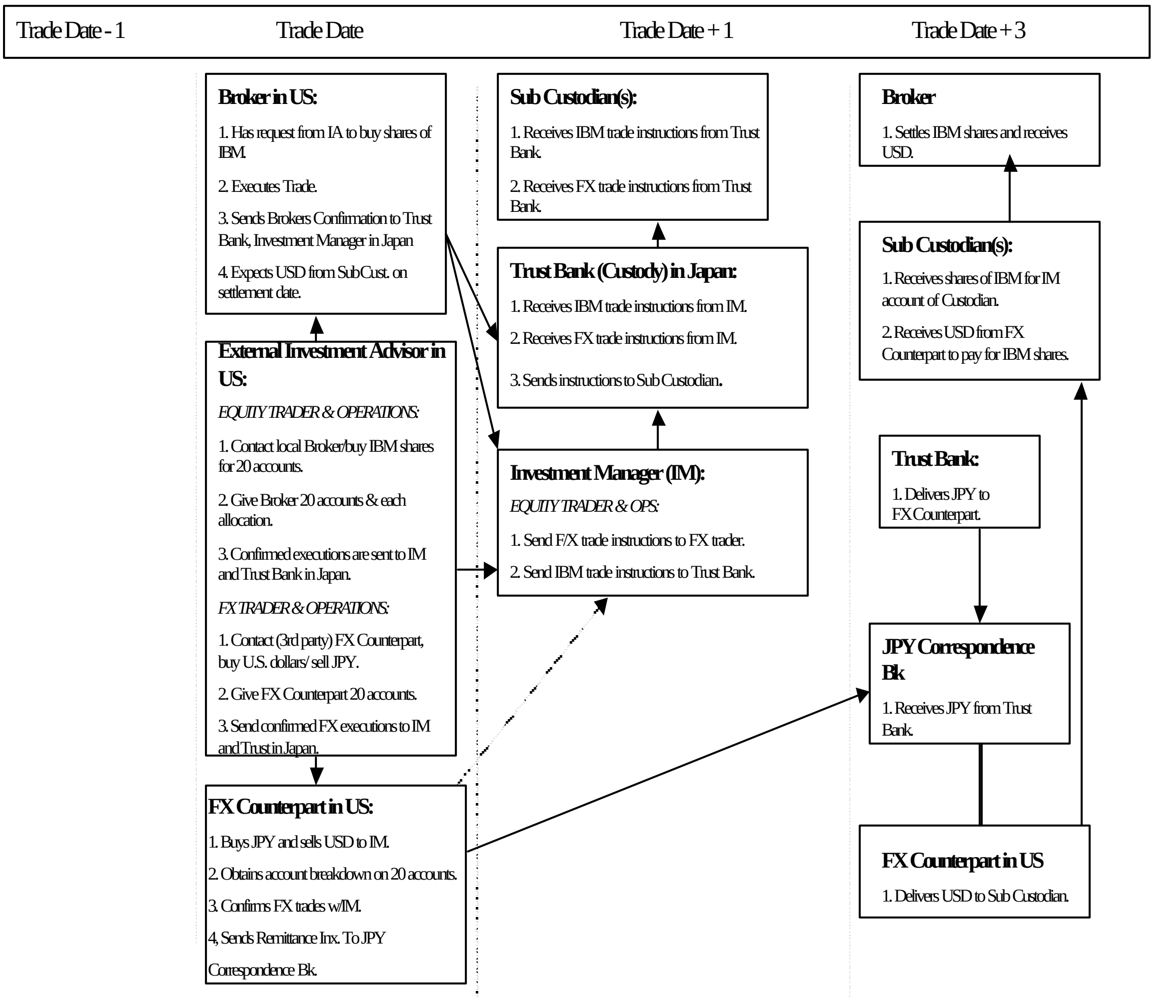
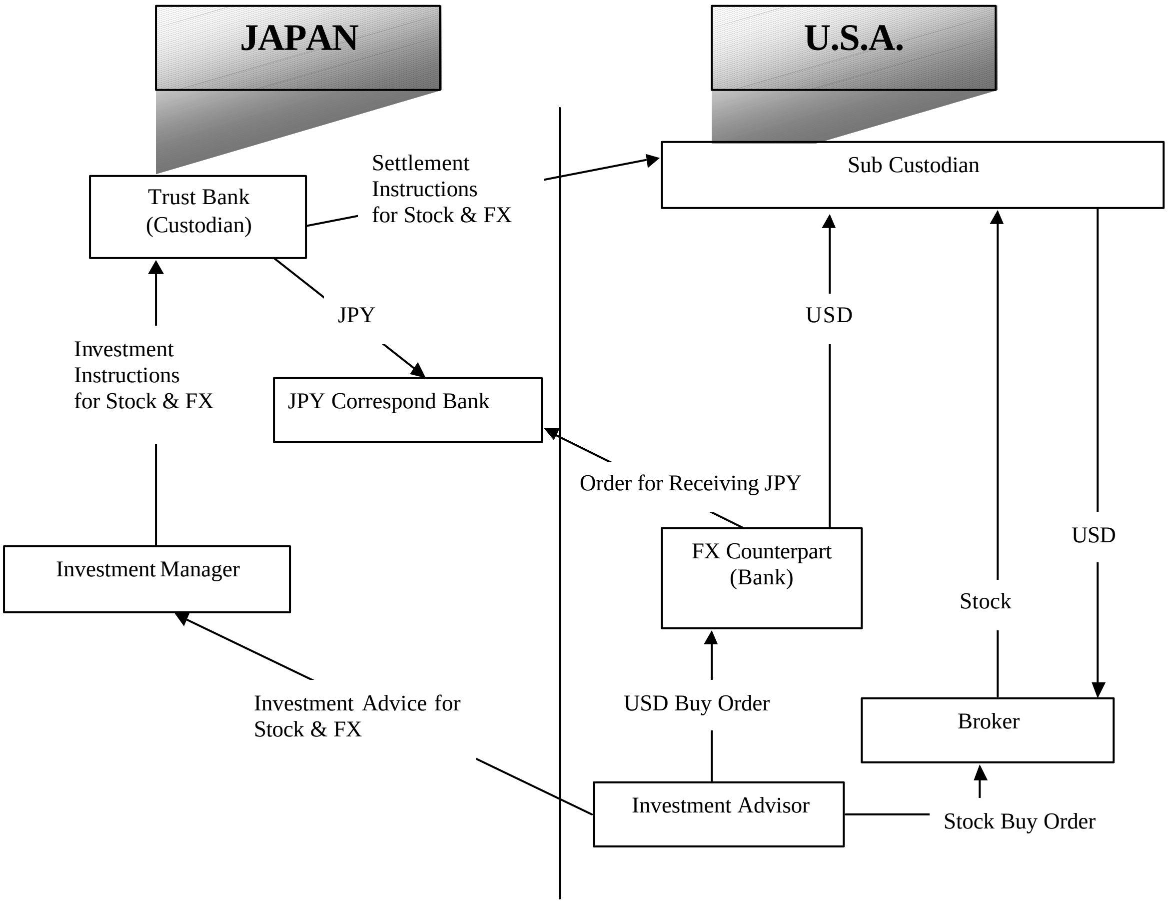
Stock
USD Buy Order
Broker
Stock Buy Order
Investment Advisor

(2)–(B) External Investment Advisor in U.S. Does Both U.S. Equity and FX Trading

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for Stock & FX
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Order for Receiving JPY
FX Counterpart
(Bank)
USD
Investment Manager
Stock
Investment Advice for
Stock & FX
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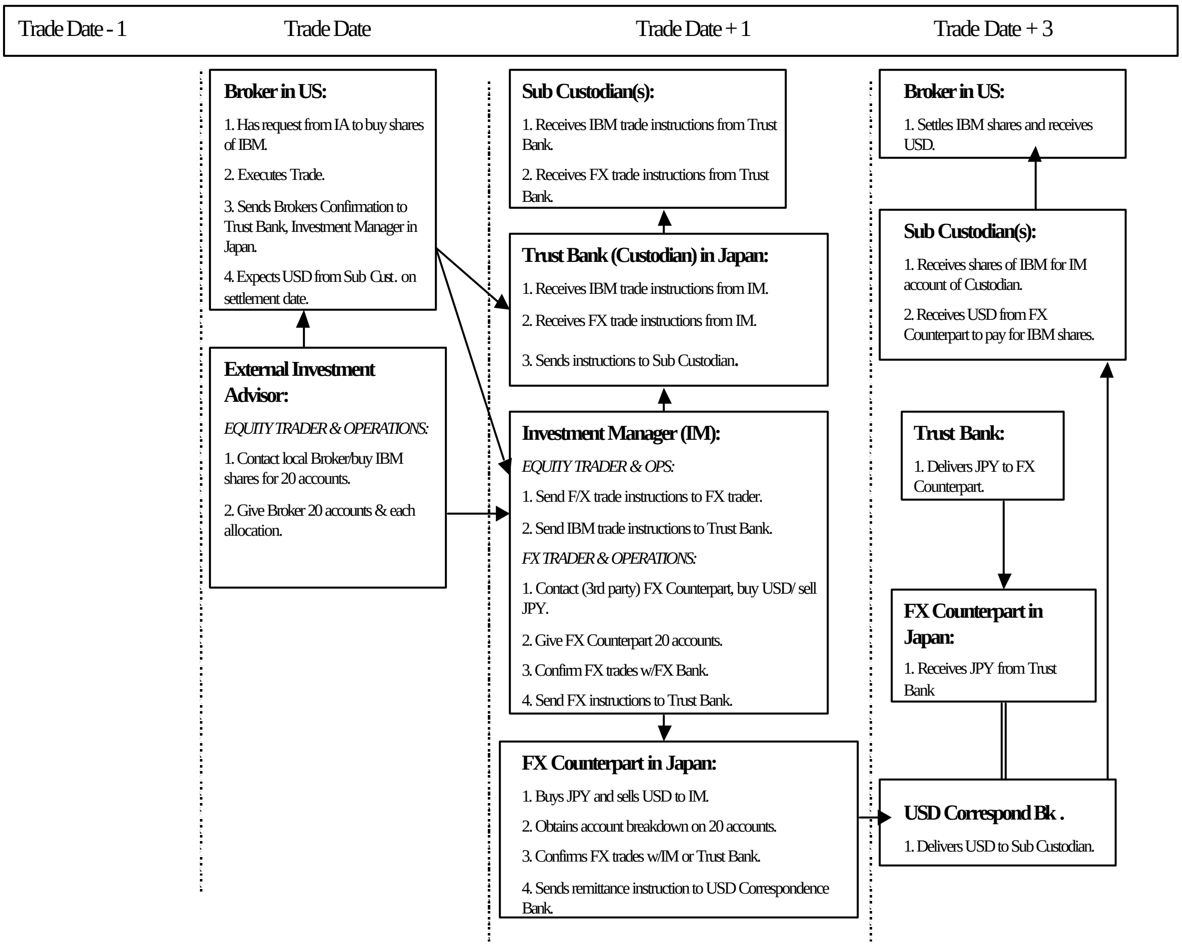
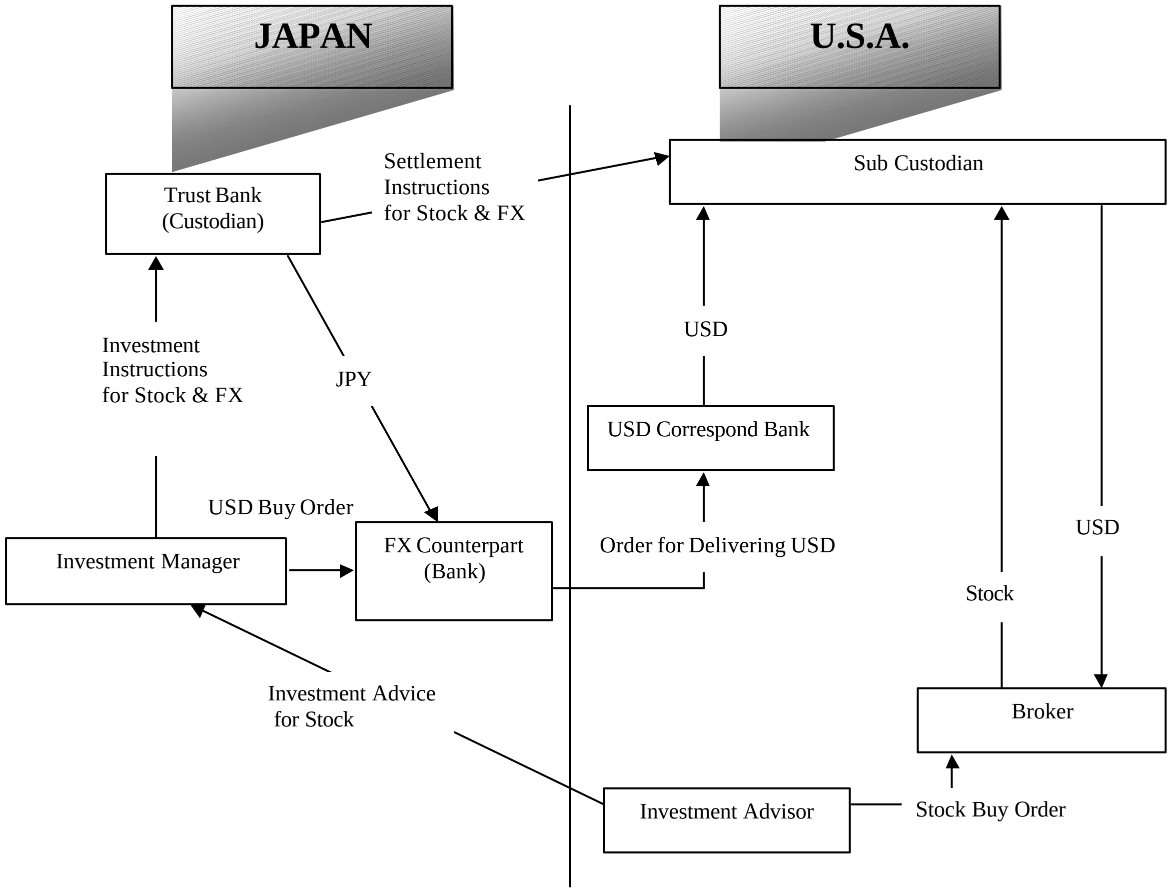
Broker
Investment Advisor
Stock Buy Order

(3) Investment Manager in Japan Does FX Trading after External Investment Advisor in U.S. Does U.S. Equity Trading

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Trust Bank
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Settlement
Instructions
for Stock & FX
Sub Custodian
Investment
Instructions
for Stock & FX
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USD
USD Correspond Bank
USD Buy Order
Investment Manager
FX Counterpart
(Bank)
Order for Delivering USD
USD
Stock
Broker
Investment Advice
for Stock
Investment Advisor
Stock Buy Order

Attachment 4

Three options regarding FX trades post the T+1 migration in the U.S. equity market

(1) In case an external investment advisor is mandated to conduct FX trades at its discretion after it concludes an agreement with an investment manager in Japan to sub-advise on investment management.

- The advantage of this scheme would be that it facilitates best execution. It also enables FX trades to take place in the later hours of the afternoon when liquidity in the New York market is likely to be reasonably higher than in the early hours of Tokyo, and the parties involved would have more time to exchange FX-related information. However, Japanese investment managers and trustee banks are likely to specify the FX bank that will be responsible for handling the business to ensure smooth after-trade confirmation and yen-based settlement. Japanese investment managers will also be required to internally discuss whether to outsource hedging as well.

(2) In case the trustee bank conducts FX trades automatically as the FX bank with the asset manager providing blanket instructions for FX trades to the trustee bank.

- In this case, the trustee bank performs the role of FX bank, which offers the advantage of simplifying the necessary information exchange and fund settlement that must be completed in a limited time frame.

The trust bank would be required to build the necessary system and infrastructure to support an FX department in the U.S. (or a night desk in Tokyo), that would be capable of reflecting the movement of U.S. equities in the portfolio during U.S. business hours, calculating the consequent dollar funding needs and ensuring that instructions are provided to remit the necessary amount of dollars to the relevant FX department. The interpretation of law over whether investment managers are allowed to grant trustee banks the discretion to trade FX is another potential issue. Constructing the necessary system and infrastructure becomes very difficult if the trustee and the sub-custodian banks are separate institutions. This approach is not conducive to best execution and gives rise to the issue of conflict of interest between the asset under custody and the FX department of the trust bank. A structure would have to be put in place to ensure that trades will be executed under appropriate terms and conditions.

(3) In case the sub-custodian bank executes FX trades where the trustee bank outsources the placement of FX orders with the bank that has custody over dollar assets under blanket instructions from the asset manager.

- Under the current scheme, there is no contractual relationship between the asset manager and the sub-custodian bank. It is therefore likely that the placing of orders for FX trades would be outsourced to the trustee bank first and the trustee bank would then further outsource the function to the FX department of the sub-custodian.

- The difference between this and the arrangement outlined under (2) above is that the trustee bank administers assets denominated in both yen and foreign currency, but the sub-custodian only administers assets denominated in foreign currencies and would be unable to monitor the status of yen funding. This problem may be resolved by having the sub-custodian administer all or part of the yen [assets] in the form of euro-yen [assets] or establish a mechanism by which the trustee bank discloses the status of yen funding to the sub-custodian.

- In case of the latter, there could potentially be administrative issues relating to the assets under management, if the sub-custodian erroneously transfers yen funds administered by the trustee bank and the problem cannot be subsequently addressed/resolved during Tokyo time. It thus becomes important to ensure that there is proper contractual agreement between the sub-custodian and the trustee bank.

- The pros and cons relating to relevant FX trades are expected to be similar to those outlined under (2) above

Attachment 5

Results of the questionnaire survey

Results of the FX survey

As mentioned above, the T+1 Subcommittee of the Tokyo Foreign Exchange Market Committee has been examining the potential impact of the global trend toward T+1 settlement, and in particular its introduction in the U.S. equity market, on the Tokyo FX market.

We surveyed 79 investment trust management and investment advisory companies that are members of the Investment Trust Association and the Japan Securities Investment Advisors Association. This was done in the belief that obtaining information on how these companies view the migration and the measures they may be contemplating would facilitate our analysis of how this may impact the Tokyo FX market.

Of the 79, 22 companies responded, resulting in a response ratio of 27.8%. Of the 22 that have responded, two indicated that they do not invest in U.S. equities.

We would like to thank the Investment Trust Association and its members for their kind cooperation.

The questions and the compiled responses are shown below. The percentages indicate the ratio against the total response.

1. Are you aware of the change in settlement period (from T+3 to T+1) in the U.S. equity market?

   Yes 95% (19 companies) No 5% (1 company)

2. Have you begun to examine how you might respond to this shortening of the settlement period in the U.S. equity market?

   Yes 20% (4 companies) No 80% (16 companies)

3. Are you also examining the possible impact this might have on the FX trades accompanying U.S. equity trades?

Yes 30% (6 companies) No 70% (14 companies)

4. Are you likely to take the following measures in trading FX after the introduction of T+1?

   a) Pre-fund foreign currency in a foreign currency account before purchasing [foreign] securities, and manage foreign currency positions for a day or longer until the FX trades settlement date after selling such securities?
      66% (10 companies)

   b) Mandate the external investment advisor to trade FX on a T+1 basis after the securities trade is conducted on a discretionary basis.
      26% (4 companies)

   c) Trade FX on a T+0 basis on the settlement date for U.S. equities (T+1).
      6% (1 co)

   d) Mandate a third party (custodian bank, trust bank, etc.) to automatically trade FX on a T+0 basis.
      40% (6 companies)

   e) Others (State details, if possible.)
      26% (4 companies)

- Have not yet decided what to do, as we are unaware of the planned change in the settlement period, or we are aware of the change but are in the process of examining the potential issues.
- Cannot decide on the course of action, as the other parties involved, such as custodians, brokers, etc., have not yet decided what course of action they will be taking.
- Will stick with the T+3 settlement period by not directly settling overseas and securing the necessary delivery time by trading over-the-counter in the Tokyo market. I.e., take an alternate route all together.

5. Why have you chosen 4? (Summary of responses received).

Regarding a)

- Enables us to secure sufficient time
- It will be possible for some of the funds to continue trading in the current manner without making any changes to the internal system.
- Have begun trading using foreign currency accounts in the case of investment trust funds. The same approach may not be taken for some of the pension "tokkin" funds that are restricted by customer attributes and customer requirements.

Regarding b)

- Can resolve disadvantage of time difference
- The most appropriate and certain way of dealing with the problem when considering the relationship between settling securities transactions and FX transactions

Regarding c)

- Cannot reject this way of approaching the issue although somewhat skeptical about whether smooth means of communication can be secured.

Regarding d)

- Most realistic, as we tend to secure FX through the trustee (trust bank) and as this may be achieved without changing the internal system.
- Enables us to secure sufficient time.
- The acquisition of foreign currency and confirming the final yen amount are the responsibilities of the investment advisor/investment trust managers. This is the optimum way to adjust the final amount.

6. What do you expect of brokers, trust banks and/or city banks in relation to FX trades once T+1 settlement is introduced?

- To facilitate same day settlement for FX trades
- To quote rates for overnight (same day) settlement
- To establish STP that supports seamless information transmission and confirmation among brokers, investment managers, trustees and FX counter-parties. Need to think from a global perspective and not only in domestic terms.
- Establish [the necessary] back office setup and systems at individual entities
- Global capabilities on the part of trust banks, such as enabling pre-funded trades

[in dollars]. (Need to be able to act like a global custodian)

7. Internal progress made in such areas as systems development to support T+1
   a) Systems developed and in place 0%
   b) Systems development underway 0%
   c) Considering systems development 27% (6 companies)
   d) No progress 73% (10 companies)

8. Potential issues, concerns, etc. ahead of the migration to T+1

- Potential fails due to miscommunication when trading via overseas investment advisors, back office feasibility when using [foreign] advisors, such as communication capabilities to make up for the time difference,
- The outflow of foreign securities investment activities from Japan
- The time available between T+1 settlement and the delivery date for investment trust redemptions
- Difference in the counter-measures taken and progress status among trust banks
- Increased reliance on systems is likely. Increased need for drafting contingency plans and other enhanced risk management capabilities
- Concerned about the stability of the market due to the migration to T+1, such as increased fails and funding problems
- Mixed use of accounting treatment, i.e., trade date based and delivery date based accounting
- Systems development and systems development costs