

JHF No.184 Monthly MBS Issue

Strategic Memorandum DSBE021

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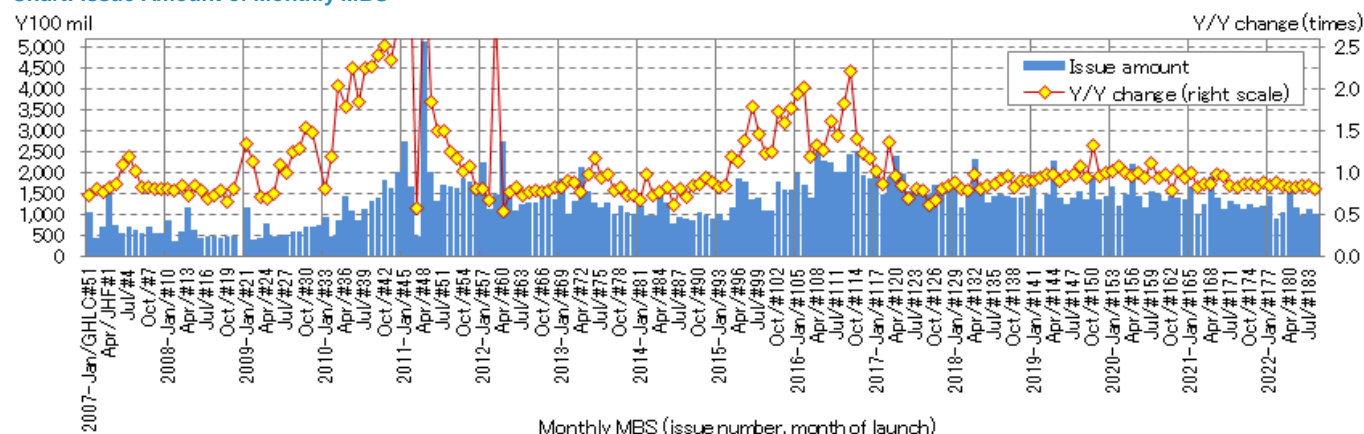
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Daiwa Securities Co. Ltd.

➤ If the 10yr JGB yield is at 0.2%, RMBS coupon should be around 0.5%

- The Japan Housing Finance Agency (JHF) plans to issue its No. 184 Monthly MBS. The coupon will be set by referencing the yield of the on-the-run 10-year JGB.
- JHF RMBS are issued with home loans as the underlying asset. The assets eligible to be used as collateral for the No. 184 issue are the Y127.3bn of Flat 35 loans originated in July. Assuming overcollateralization at a credit enhancement ratio of 20.9%, which is what it was the previous issue, the issuance amount will be Y100.7bn.
- The amount of Flat 35 loans in July declined 19% y/y. Issuance has been declining at a y/y rate of at least 10% since July 2021. This could be attributed in part to intense competition among private sector lenders to write mortgages targeting younger borrowers. The average age of borrowers applying for a new Flat 35 loan was 43, a new record-high.
- Based on our prepayment model, we estimate a WAL of 9.96 years (based on 9 August closing prices; same hereinafter). The expected WAL based on the JHF's PSJ Forecast Statistical Data is 9.29 years.
- At a launch spread the same as the previous issue of 28bp, the coupon of the upcoming issue will be 0.44%. In this case, the PSJ model YCS would be 5.1bp, 0.5bp higher than the previous issue's 4.6bp. The PSJ model YCS of the previous issue in the secondary market is 6.0bp, which would mean the upcoming issue will have a coupon of 0.45% and launch spread of 29bp.
- We think it appropriate that supply and demand will meet at the launch spread of about 28-30bp. If so, the coupon would be about 0.44-0.46%.

Chart: Issue Amount of Monthly MBS



Source: JHF; compiled by Daiwa Securities.

Note: Estimate for No. 184 issue.

Issuance of JHF MBS and Situations of Flat 35

No. 184 to be launched in August

The Japan Housing Finance Agency (JHF) plans to price (launch) its No. 184 MBS this month. Issuance terms are determined by the spread-pricing method, in which a new issue's coupon is set on the launch date by adding a launch spread—which is determined based on investor demand—to the compound yield on a benchmark 10Y JGB (JB367 in this case) at the time of the launch. The launch date is scheduled in mid-August, and the payment date is scheduled on 26 August.

Issuance amount of about Y101bn

Candidate trust assets for the No. 184 totaled Y127.3bn, all of which were Flat 35 loans originated in July. The issue is likely to have the highest ratings from S&P and R&I. The issue amount is to be announced on 15 August. If the credit enhancement ratio is unchanged from that for the previous issue at 20.9%, the issue amount is estimated at Y100.7bn.

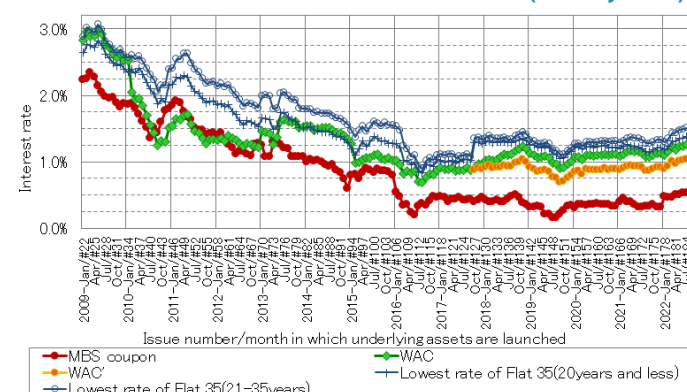
The amount of Flat 35 loans declined 19% y/y in July

The amount of new Flat 35 mortgages originated in July was Y127.3bn, down m/m owing to seasonality and down 19% y/y. The lowest retail rate on the mortgages was 1.51% (including group credit life insurance premiums), up 0.02ppt m/m and up 0.18ppt y/y. The lowest rate on Flat 20 mortgages (with terms of 20 years or less) was 1.38%, up 0.02ppt m/m and up 0.18ppt y/y.

Average age of new borrowers reached another record-high

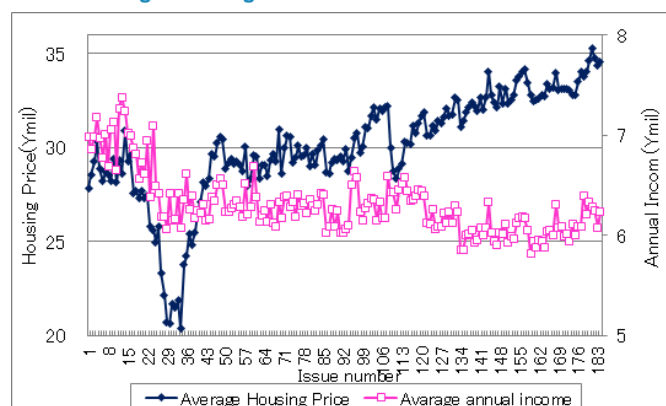
The average age of borrowers applying for a new Flat 35 loan was 43, another record high (see pp7-8). The average age tends to rise when there are many borrowers refinancing, but only 3% of the loans were refs in July, so that does not explain it. We think it was largely owing to a decline in the number of younger borrowers. Additionally, housing prices have been rising, but the average annual incomes of borrowers have not been.

Chart: Interest Rate of Flat 35 Loans and JHF MBS (monthly trend)



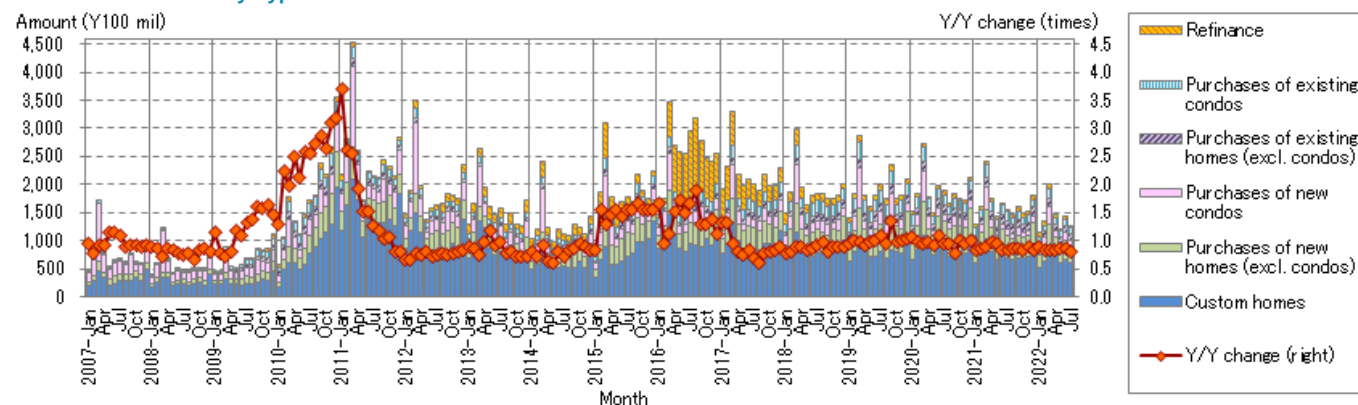
Source: JHF; compiled by Daiwa Securities.

Chart: Average Housing Price and Annual Income of Borrowers



Source: JHF; compiled by Daiwa Securities.

Chart: Flat 35 Loans by Type of Loans



Source: JHF; compiled by Daiwa Securities.

Terms for the previous issue

Launch spread of 28bp and coupon of 0.53%

The No. 183 (Y113.5bn) was launched on 21 July with a coupon of 0.53 %. The coupon was determined by adding the launch spread of 28bp on the compound yield of benchmark JB367. The OAS at launch (our estimate; same hereinafter) stood at -14.6bp (5.4bp higher than previous issue) and the YCS was -4.3bp (4.5bp higher than the previous issue).

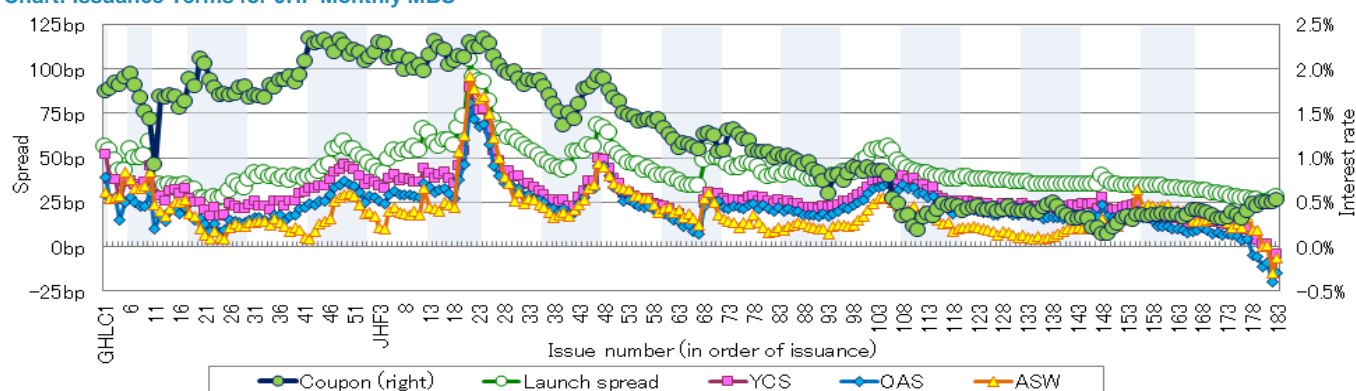
The BOJ's yield curve control policy sets a ceiling on the 10yr JGB of 0.25%

Relative to June, launch spreads increased by 2bp and the coupon increased 3bp. Although OAS and YCS increased, both are still in negative territory. This can mostly be explained by the high interest rate sensitivity based on the long maturity forecast by our model and by the reference JGB yield being stuck below the 0.25% cap set by the BOJ's YCC policy, which made it easier for JGB yields in the 7-10yr zone and the over-10-year zone to test levels above 0.25%.

Liquidity premium on long-term bonds

In the issuance market for long-term bonds, which is focused on maturities of 10-20yrs, the liquidity premium has been rising since June. Although that premium has also been added to JHF RMBS spreads, it is relatively small in nominal terms, probably a reflection of conditions in the secondary market and tight supply-demand.

Chart: Issuance Terms for JHF Monthly MBS



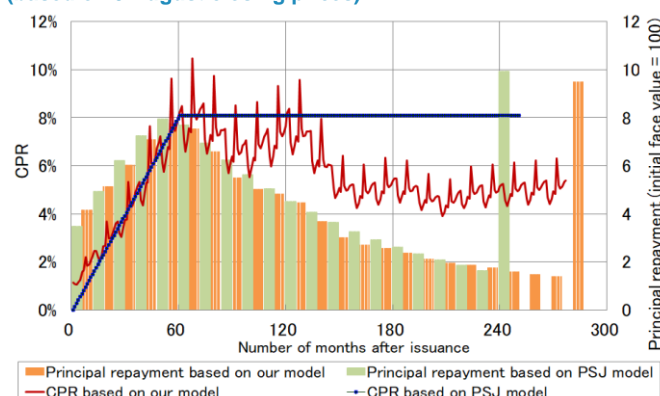
Source: JHF and our estimates.

Note: The background colors indicate different fiscal years.

Different risk premiums depending on expected cash flow distribution

With regard to the pricing of JHF MBS, it should be noted that the risk premium varies depending on the expected cash flow distribution. The expected cash flows of the primary JHF MBS based on our prepayment model have terms that are somewhat longer than those based on the PSJ Forecast Statistical Data. As a result, YCSs based on our prepayment model are several basis points lower than those based on the PSJ Forecast Statistical Data. Following a minor change to our model in July 2019 we have continued updating our parameters. This had caused a steady lengthening of the forecast maturity at issuance since the No. 147, but this trajectory changed from the No. 165.

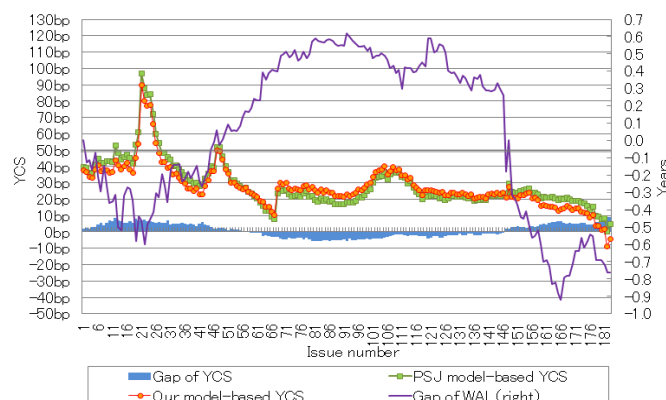
Chart: Expected CPR & Principal Repayment for No. 184 Issue (based on 9 August closing prices)



Source: Our estimates.

Note: Although principal repayments are made every month, the graph show annual repayment totals.

Chart: Difference in YCS for Monthly MBS at Launch



Source: Our estimates.

Cash flow characteristics and issuance terms for No. 184

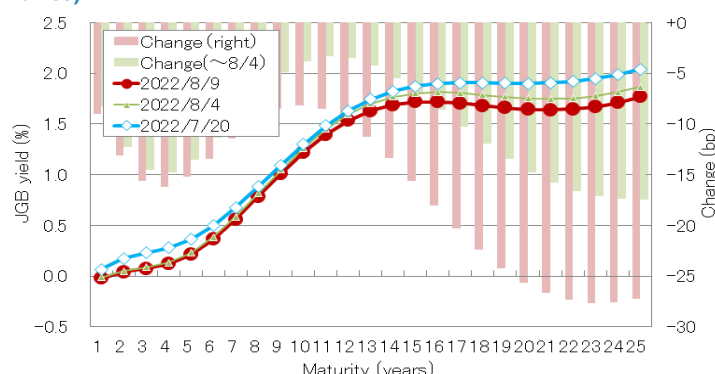
We take a look at the issuance terms for the upcoming issue. Based on expected cash flow using our prepayment model and the PSJ model, we estimate the issuance terms (the coupon and launch spread) and the risk premiums.

Expected maturity of 9~10 years

The expected cash flow distribution for the upcoming issue (the chart on the previous page, based on 9 August closing prices; hereinafter the same unless otherwise noted) is about the same as the previous issue (at the time of its launch; same hereinafter).

- Based on our model, the expected WAL is 9.96 years (10.08 years for the previous issue) and the expected final maturity 23.1 years (23.2 years). The PSJ forecast is 7.00% (vs. 6.89% for the previous issue).
- The PSJ Calculation Statistical Value (average) is 8.10% (vs. 8.07% for the previous issue). Accordingly, the expected WAL is 9.29 years (vs. 9.32 years for the previous issue) and the expected final maturity 20.1 years (20.2 years).

Chart: Change in 3Y-Forward Rate (from the day before launch day of No.183)



Source: JHF; compiled by Daiwa Securities.

Note: WAC' means the Weight Average Coupon excl. premiums for JHF group credit life insurance

Forecast maturities have shortened slightly relative to the previous issue, because long-term JGB yields overall have been declining, as have forward yields. With the refinancing rate expected to decline in the future, estimated prepayments are likely to rise, which shortens the cash flow expected from RMBS. The WAC of the underlying assets (weighted average coupon of the home loans) rose slightly relative to the previous issue.

The underlying loan pool's WAC (weighted average coupon; see pp. 7-8) is 1.26% and the WAC' 1.04%, 0.02ppt higher than the previous issue's.

Chart: Launch Spread Estimates for No. 184 MBS (based on 9 August closing prices)

Valuations of JHF_MBS_#184 Pricing(Simulation)										9-Aug-22 (Tokyo Close)
Base Yield: JGB(367G) YTM 0.160 %										
Launch Spread	Coupon	Valuations of Cash Flows							Indications of Previous RMBS Issue (#183)	
		Daiwa Model				PSJ Model				
		Dynamic	Static			PSJ forecast Statistical Data(Ave)				
		OAS	YCS	ASW	ModDur	YCS	ASW	ModDur		
25 bp	0.41 %	-16.9	-6.9	-6.9	9.651	2.0	-1.3	9.041	(Issuance Terms)	
26 bp	0.42 %	-15.8	-5.9	-5.9	9.644	3.1	-0.3	9.035	Launch Spread=28bp	
27 bp	0.43 %	-14.8	-4.9	-4.9	9.636	4.1	0.7	9.029	Coupon=0.53%	
28 bp	0.44 %	-13.7	-3.8	-4.0	9.629	5.1	1.7	9.022	(Valuations at the time of Launch)	
29 bp	0.45 %	-12.7	-2.8	-3.0	9.621	6.2	2.7	9.016	[CF based on Daiwa Model]:	
30 bp	0.46 %	-11.6	-1.7	-2.0	9.614	7.2	3.7	9.010	OAS=-14.6bp, YCS=-4.3bp, ASW=-6.4bp	
31 bp	0.47 %	-10.6	-0.7	-1.0	9.606	8.2	4.7	9.003	[CF based on PSJ Model]:	
32 bp	0.48 %	-9.5	0.3	0.0	9.598	9.2	5.6	8.997	YCS=4.6bp, ASW=-1bp	
...									(Valuations in the secondary market)	
36 bp	0.52 %	-5.4	4.5	3.9	9.568	13.3	9.6	8.972	[CF based on Daiwa Model/Daiwa Price]:	
37 bp	0.53 %	-4.3	5.5	4.9	9.561	14.4	10.6	8.965	OAS=0bp, YCS=9.7bp, ASW=8.8bp	
38 bp	0.54 %	-3.3	6.5	5.9	9.553	15.4	11.5	8.959	[CF based on PSJ Model/JSDA price]:	
...									BEY=0.448%, YCS=6bp, ASW=2.6bp	
40 bp	0.56 %	-1.2	8.6	7.9	9.538	17.5	13.5	8.946		
41 bp	0.57 %	-0.1	9.7	8.8	9.530	18.5	14.5	8.940		
<div><div><Daiwa Model></div><div>PSJ 7.00 %</div><div>WAL 9.96 years</div></div> <div><div><PSJ Model/based on PSJ Forecast Statistical Data></div><div>Ave: 8.10 % (Median: 8.38) %</div><div>9.29 years (9.17) years</div></div>										

Source: Compiled by Daiwa Securities.

Note: 1) Figures in colored cells show similar indications to those in the previous issue, as indicated in the right section (Indications of Previous MBS Issue) with the same colors. Spreads in the previous issue at launch are based on those at the time of pricing. The spreads in the previous issue in the secondary market used in the Daiwa model are based on Daiwa prices, and the spreads in the previous issue in the secondary market used in the PSJ model are based on the JSDA's Trading Reference Statistical Data.

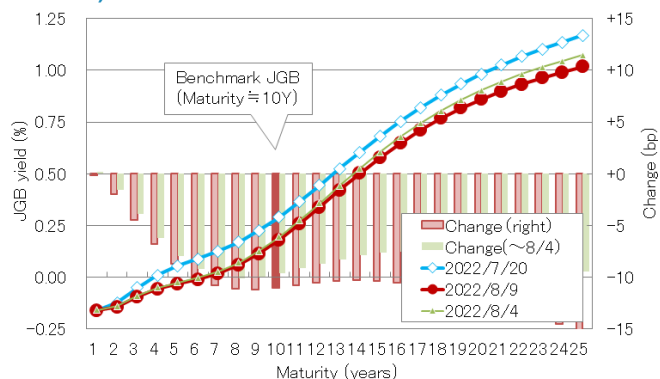
2) Figures for both Trading Reference Statistical Data and PSJ Forecast Statistical Data are average figures.

3) Estimated cash flow is based on the assumption that clean-up call options are exercised in initial April or October after the outstanding amount becomes 10% or less of the original.

Launch spread indications

The previous issue (No. 183) was launched at a time when the on-the-run 10-year JGB yield was trading near its ceiling of 0.25%. Later, US long-term rates declined on the emergence of recession fears, and the 10yr JGB yield followed suit.

Chart: JGB Yield Curve Changes (from the day before launch day of No.183)



Source: Compiled by Daiwa Securities.

If the launch spread is the same as the previous issue at 28bp, the No. 184 will have a coupon of 0.44%. Based on the average PSJ forecast, the YCS would be -3.8bp, 0.5bp higher (less negative) than when the previous issue was launched. Additionally, the OAS would be -13.7bp, 0.9bp less negative than the OAS when the previous issue was launched (based on the 9 August close).

This deeply negative OAS based on market conditions can probably be attributed to our model for estimating OAS reflecting volatility of the swaption market and to that volatility being high recently. Our prepayment model also shows a widening of the option premium (the difference between YCS and OAS), because of the rise in interest rate sensitivity since then along with synergistic effects.

The connections with the previous issue are shown as follows (secondary market levels and benchmark yield are as of the 9 August close). In the secondary market, because our mid-price for on-the-run bonds is a somewhat overly conservative price level, we look closely at the level of and change in risk premium based on reference trading values, which are close to actual market prices.

(Connection with risk premium of previous issue)

【Pricing using our model's cash flow estimates】

- The No. 183's launch OAS was -14.6bp and the YCS -4.3bp. Based on the similar OAS and YCS, the No. 184's launch spread would be 27-28bp and the coupon 0.43-0.44%.
- Based on our mid-price (99.63) for the previous issue in the secondary market, OAS would be 0.0bp and YCS 9.7bp. Assuming an OAS and YCS close to these levels, the No. 184's launch spread would be 41bp and the coupon 0.57%.
- When based on the reference trading value (100.74) for the previous issue in the secondary market, OAS would be -12.2bp and YCS -2.2bp. Assuming an OAS and YCS close to these levels, the No. 184's launch spread would be 30bp and the coupon 0.46%.

【Pricing using average PSJ forecast-based cash flow estimates】

- The No. 183's launch YCS was 4.6bp. Based on the similar YCS, the No. 184's launch spread would be about 27-28bp and the coupon 0.43-0.44%.
- In the secondary market, the No. 183's YCS is 6.0bp. In line with this, the No. 184's launch spread would be about 29bp and the coupon 0.45%.

(Demand forecast for No. 184 issue and issuance level)

Growth remains weak in Flat 35 usage and RMBS issuance

We expect the amount of the upcoming issue to be about 20% smaller than the year-ago issue. Since July 2021, issuance has been declining at a y/y rate of at least 10% because of the weak volume of Flat 35 mortgages. Because Japan's overall home loan market is growing, it is probably the case that the attractiveness of mortgages offered by private-sector lenders has increased by more than that of Flat 35 loans. Private-sector home loans can become more competitive by offering various options, including a lower interest rate and lower group credit insurance premiums, commensurate with borrower characteristics. Additionally, borrowers who do not feel they bear much risk from rising interest rates (because neither inflation nor growth expectations are high) are likely to opt for either adjustable-rate mortgages (ARMs) or delayed ARMs instead of fully fixed-rate home loans like Flat 35 loans, since this allows them to lower their near-term interest burden.

**Flat 35 SDG compliance
and JHF RMBS**

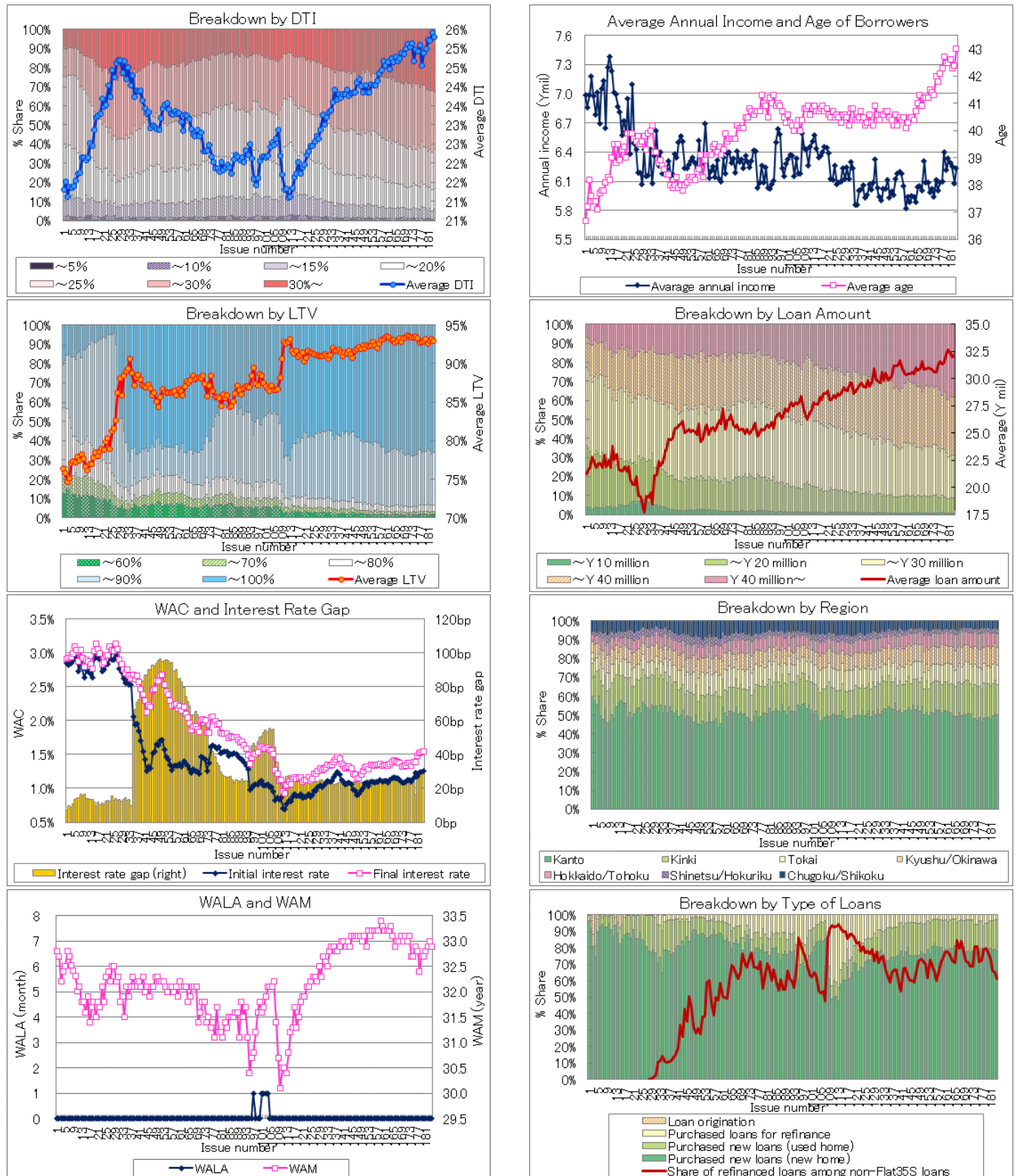
Modifications to Flat 35 offerings, including launch of the Flat 35S (ZEH) scheduled for October and the increase in Flat 35S energy efficiency standards, are meant to offer SDG options to Japanese and help Japan achieve its GHG emission reduction targets. Improving the performance and transparency of the houses that serve as collateral for the underlying loan assets injects energy into the secondary market for housing and strengthens the credit of RMBS, making it easier for JHF RMBS to preserve their market value.

That by itself may not be enough to increase usage of Flat 35 loans, however. Although growth in the RMBS issuance that funds Flat 35 loans is unlikely, we think disruptions to the supply-demand balance are unlikely, as well. We will keep our eye on developments in the JHF RMBS market ahead of the new system's launch. We expect issuance of the upcoming No. 184 to go well, thanks to the dialogue with market participants about developments in the secondary market and investor demand for long-term bonds.

**Coupon of mid-0.4%
level**

The personal opinion of your author is that the launch spread for this issue will confirm sufficient demand and be either 28-30bp. In this case, the coupon would be 0.44-0.46% (based on 9 August closing prices)

Characteristics of Underlying Loan Pools for All JHF Monthly MBSs



Source: JHF; compiled by Daiwa Securities.

Note: Candidate pool used for No. 184 issue.

Characteristics of Underlying Loans: No. 184 Monthly MBS and Last Six Issues (No. 178-183)

	JHF #178	JHF #179	JHF #180	JHF #181	JHF #182	JHF #183	JHF #184	Ave. of previous 6 issues	Change from #183
Loan Pool Selected in	Jan-2022	Feb-2022	Mar-2022	Apr-2022	May-2022	Jun-2022	Jul-2022		
Loan Application Started in	Mar-2019	Aug-2019	Nov-2018	Jul-2019	Nov-2019	Apr-2020	Feb-2020		
Repayment Started in	Jan-2022	Feb-2022	Mar-2022	Apr-2022	May-2022	Jun-2022	Jul-2022		
Initial Outstanding Entrusted Assets (Y mil)	114,504	134,748	202,254	147,021	121,961	143,543	127,324	144,005	-16,219
Issue Size (Y mil)	90,700	106,900	160,700	117,000	97,000	113,500	TBD	114,300	-
Excess Collateral (Y mil)	23,804	27,848	41,554	30,021	24,961	30,043	TBD	29,705	-
Overcollateralization	20.7%	20.6%	20.5%	20.4%	20.4%	20.9%	TBD	20.6%	-
Number of Loans	3,656	4,265	6,271	4,504	3,777	4,488	3,961	4,494	-527
Average Outstanding Loan (Y mil)	31.320	31.594	32.252	32.642	32.290	31.975	32.144	32.012	+0.169
Average LTV	92.79%	92.90%	93.14%	92.57%	92.88%	93.13%	92.98%	92.90%	-0.15%
Average DTI	24.55%	24.88%	25.00%	25.23%	25.20%	25.41%	25.31%	25.05%	-0.10%
Average LTV for Refinance	86.50%	87.19%	87.05%	72.80%	70.61%	72.85%	74.22%	79.50%	+1.37%
Average DTI for Refinance	18.56%	18.63%	18.17%	18.83%	19.24%	19.66%	19.33%	18.85%	-0.33%
Average Annual Income of Obligors (Y mil)	6.398	6.214	6.330	6.287	6.250	6.081	6.232	6.260	+0.151
Average Age of Obligors	42.7	42.5	42.5	42.6	42.3	42.4	43.0	42.5	+0.6
WAC (Initial Rate)	1.10%	1.15%	1.23%	1.18%	1.23%	1.24%	1.26%	1.19%	+0.02%
WAC (Final Rate)	1.34%	1.39%	1.39%	1.48%	1.52%	1.53%	1.55%	1.44%	+0.02%
WALA (Weighted Average Loan Age)	0	0	0	0	0	0	0	0	+0
WALA for Refinance	119	122	125	127	127	129	132	125	+3
WAM	389	392	392	394	395	396	395	393	-1
Maturity Structure of Loans at Origination (% share)	Up to 10Y	0.1%	0.1%	0.1%	0.1%	0.0%	0.1%	0.1%	+0.0%
	10-20Y	6.4%	5.6%	5.3%	5.5%	4.8%	4.8%	5.4%	+0.1%
	20-25Y	5.9%	5.5%	5.1%	4.5%	4.9%	3.7%	4.9%	+1.0%
	25-30Y	8.0%	6.8%	7.3%	7.1%	7.4%	7.2%	7.3%	-0.4%
	Over 30Y	79.5%	82.0%	82.2%	82.8%	82.9%	84.2%	82.3%	-0.7%
% share of loans with bonus payments	(in number)	7.6%	8.5%	8.9%	7.7%	7.5%	6.9%	7.0%	+0.2%
	(in value)	8.2%	9.5%	9.4%	8.3%	8.1%	7.6%	8.5%	+0.0%
Type of Loan	new	93.2%	95.0%	95.1%	96.3%	96.4%	97.0%	96.9%	-0.0%
	refinanced	6.8%	5.0%	4.9%	3.7%	3.6%	3.0%	3.1%	+0.0%
Loan Amount at Origination (% share)	Up to Y10 mil	1.1%	0.9%	0.8%	0.8%	1.0%	0.9%	0.9%	-0.1%
	Y10-20 mil	9.3%	8.5%	8.1%	7.5%	7.8%	8.0%	8.2%	-0.2%
	Y20-30 mil	24.2%	24.5%	23.6%	21.8%	21.9%	22.1%	23.0%	+0.5%
	Y30-40 mil	28.2%	30.7%	28.4%	30.1%	31.3%	30.6%	29.9%	-0.0%
	Y40-50 mil	18.7%	17.8%	19.5%	20.2%	19.7%	20.5%	19.4%	-0.2%
	Over Y50 mil	18.6%	17.7%	19.6%	19.5%	18.3%	17.8%	18.6%	+0.0%
Loan Amount by Region (% share)	Hokkaido/Tohoku	7.3%	7.7%	7.1%	7.7%	6.7%	5.6%	7.0%	+1.5%
	Kanto	48.2%	48.6%	51.5%	47.8%	49.7%	50.5%	49.4%	-0.6%
	Shinetsu/Hokuriku	2.4%	1.8%	2.0%	2.1%	2.0%	2.0%	2.0%	+0.6%
	Tokai	10.3%	9.5%	9.4%	9.7%	10.5%	9.9%	9.9%	+0.3%
	Kinki	18.9%	18.2%	16.2%	17.7%	16.8%	17.8%	17.6%	-1.5%
	Chugoku	2.9%	3.0%	2.7%	3.0%	3.1%	2.9%	3.0%	+0.3%
	Shikoku	1.3%	1.2%	1.1%	1.8%	1.4%	1.2%	1.3%	-0.0%
	Kyushu/Okinawa	8.8%	10.1%	10.1%	10.2%	9.8%	10.1%	9.6%	-0.5%

Source: JHF; compiled by Daiwa Securities.

Note: Candidate pool used for No. 184 issue.

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- 2: Outperform TOPIX/benchmark index by 5-15% over the next 12 months.
- 3: Out/underperform TOPIX/benchmark index by less than 5% over the next 12 months.
- 4: Underperform TOPIX/benchmark index by 5-15% over the next 12 months.
- 5: Underperform TOPIX/benchmark index by more than 15% over the next 12 months.

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Notification items pursuant to Article 37 of the Financial Instruments and Exchange Law

(This Notification is only applicable to where report is distributed by Daiwa Securities Co. Ltd.)

If you decide to enter into a business arrangement with our company based on the information described in this report, we ask you to pay close attention to the following items.

- In addition to the purchase price of a financial instrument, our company will collect a trading commission* for each transaction as agreed beforehand with you. Since commissions may be included in the purchase price or may not be charged for certain transactions, we recommend that you confirm the commission for each transaction. In some cases, our company also may charge a maximum of ¥2 million per year as a standing proxy fee for our deposit of your securities, if you are a non-resident.
- For derivative and margin transactions etc., our company may require collateral or margin requirements in accordance with an agreement made beforehand with you. Ordinarily in such cases, the amount of the transaction will be in excess of the required collateral or margin requirements**.
- There is a risk that you will incur losses on your transactions due to changes in the market price of financial instruments based on fluctuations in interest rates, exchange rates, stock prices, real estate prices, commodity prices, and others. In addition, depending on the content of the transaction, the loss could exceed the amount of the collateral or margin requirements.
- There may be a difference between bid price etc. and ask price etc. of OTC derivatives handled by our company.
- Before engaging in any trading, please thoroughly confirm accounting and tax treatments regarding your trading in financial instruments with such experts as certified public accountants.

* The amount of the trading commission cannot be stated here in advance because it will be determined between our company and you based on current market conditions and the content of each transaction etc.

** The ratio of margin requirements etc. to the amount of the transaction cannot be stated here in advance because it will be determined between our company and you based on current market conditions and the content of each transaction etc.

When making an actual transaction, please be sure to carefully read the materials presented to you prior to the execution of agreement, and to take responsibility for your own decisions regarding the signing of the agreement with our company.

Corporate Name: Daiwa Securities Co. Ltd.

Registered: Financial Instruments Business Operator, Chief of Kanto Local Finance Bureau (Kin-sho) No.108

Memberships: Japan Securities Dealers Association, The Financial Futures Association of Japan, Japan Investment Advisers Association, Type II Financial Instruments Firms Association, Japan Security Token Offering Association