

JHF No.199 Monthly MBS Issue

Strategic Memorandum DSBE028

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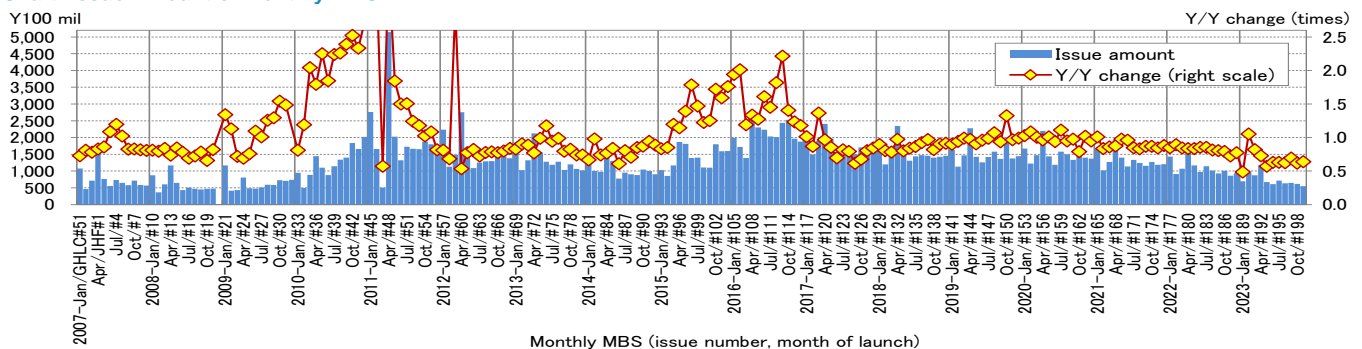
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Daiwa Securities Co. Ltd.

➤ RMBS issuance in Y50bn range as higher JGB yields weigh on Flat 35 growth

- The Japan Housing Finance Agency (JHF) plans to issue its No. 199 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 total assets eligible for use as collateral for the No. 199 Monthly MBS, almost all of which consisted of Flat 35 mortgages originated in October, came to Y69.6bn. If the entire amount of candidate trust assets is used as collateral at the same credit enhancement ratio as for the previous issue, the issuance amount will be Y54.8bn.
- This RMBS issuance is likely to be equivalent to about 60% of the issuance for the same period last year. The issuance of Flat 35, an asset eligible for use as collateral, declined by 35% y/y in October and the Flat 35 usage amount has continued to decline by more than 30% y/y since the spring. Mortgage borrowers are now overwhelming using variable-rate loans, which easily reflect reduced interest rate burdens stemming from the BOJ's negative policy rate, rather than Flat 35, for which rates are rising.
- Based on our prepayment model, we estimate a WAL of 10.85 years (based on 10 Nov closing prices; same hereinafter). The PSJ Calculation Statistical Value (average) is 7.46%. Accordingly, the expected WAL based on the PSJ model is 9.63 years.
- At a launch spread the same as the previous issue of 34bp, the coupon of the upcoming issue will be 1.19%. In this case, the PSJ model YCS would be 11.3bp, up 1.9bp versus the previous issue. The BEY, which is the trading reference statistical data for the previous bond in the secondary market evaluated using the PSJ model, is 1.179% and the YCS is 9.0bp. The launch spread for the upcoming issue, which is close to the PSJ model valuation, will be 33bp.
- We think it appropriate that supply and demand will meet at the launch spread of about 32-34bp. If so, the coupon would be about 1.17-1.19%.

Chart: Issue Amount of Monthly MBS



Source: JHF; compiled by Daiwa Securities. Note: Estimate for No. 199 issue.

Issuance of JHF MBS and Situations of Flat 35

No. 199 to be launched in November

The Japan Housing Finance Agency (JHF) plans to price (launch) its No.199 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 10-year JGB (JB372G in this case) at the time of the launch. The launch date is scheduled for mid-November and the scheduled payment date is 27 November.

Possible issuance amount of around Y54.8bn

Almost all of the Y69.6bn in Flat 35 mortgages eligible for use as collateral for the No. 199 Monthly MBS originated in October. The issue is likely to have the highest ratings from S&P and R&I. The issue amount is to be announced on 13 November. If the credit enhancement ratio is unchanged from that for the previous issue at 21.2%, the issue amount is estimated at Y54.8bn.

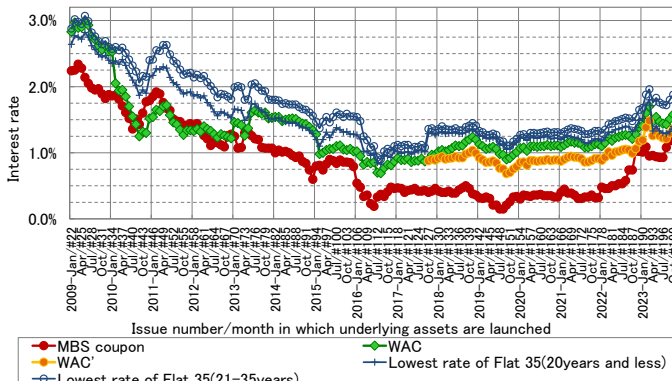
Oct Flat 35 rates up, reflecting Sep RMBS rate

The lowest retail rate on the mortgages was 1.88% (including group credit life insurance premiums), up 0.08ppt m/m. The lowest rate on Flat 20 mortgages (with terms of 20 years or less) was 1.40%, up 0.08ppt m/m. The rate on the RMBS (197 MBS) launched in September reflects a 0.06ppt rise from the previous issuance (1.02% to 1.08%).

Avg age of new Flat 35 users hits record high

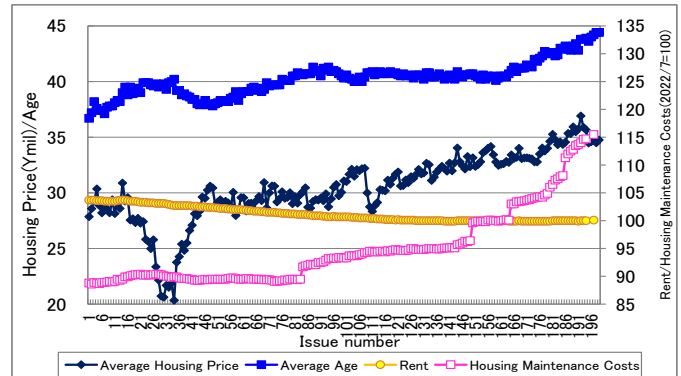
The October Flat 35 issuance fell 35% y/y if we assume all of the assets eligible for use as collateral came to Y69.6bn. Issuance has continued declining since the beginning of the year, at more than 30% from the previous year. This is because the 10-year JGB yield has increased under the BOJ's yield curve control (YCC) policy and the Flat 35 rate has increased accordingly. Variable-rate loans appeal to mortgage borrowers whose interest rates are likely to be suppressed if the BOJ maintains a negative policy rate while waiting for wage growth to pick up. The average age of borrowers was 44.4 years old, unchanged from the previous month's record high.

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



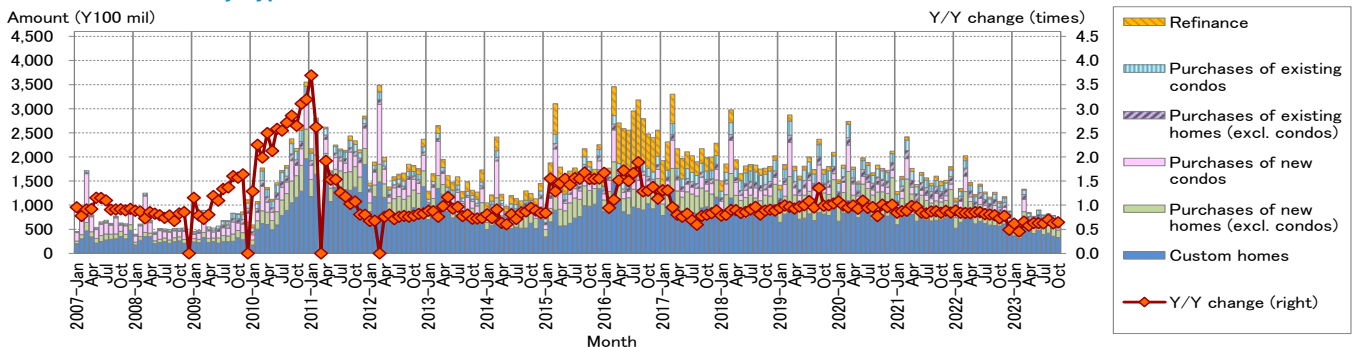
Source: JHF; compiled by Daiwa Securities.

Chart: Avg Age of Flat 35 Users, Home Prices vs CPI Housing Components



Source: JHF, Ministry of Internal Affairs and Communications. Housing maintenance costs are "equipment repair and maintenance" for CPI housing

Chart: Flat 35 Loans by Type of Loans



Source: JHF; compiled by Daiwa Securities.

Terms for the previous issue

Launch spread of 34bp and coupon of 1.18%

The No. 198 (Y64.5bn) was launched on 20 October. The coupon of 1.18% was determined by adding the (nominal) launch spread of 34bp to the compound yield of the benchmark JB372G. The OAS at launch (our estimate; same hereinafter) stood at -11.9bp (7.0bp lower than the previous issue). Based on our model, the yield curve spread (YCS) was -4.0bp (1.6bp lower than previous issue) at the time of the launch. Based on the PSJ Forecast Statistical Data, YCS was 9.4bp (4.5bp lower than previous issue) at the time of the launch.

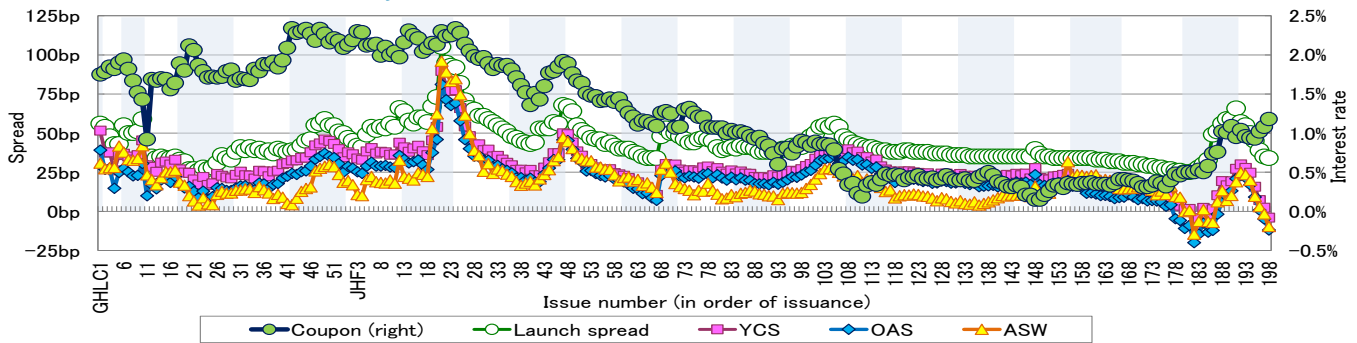
Confirming depth of investment demand, reduced nominal spread

The nominal spread narrowed 1bp compared to two launches ago, but the coupon rate rose on the higher base rates. The sluggish growth in issuance (down 38% y/y) and the rise in base rates stimulated investment demand, which appears to have maintained supply and demand despite the nominal spread decline. Secondary RMBS further reduced off-the-run liquidity at prices far from par. However, there is a certain amount of trading in the current zone, confirming actual demand for BEY and spreads.

Wider negative range for OAS

YCS and OAS declined by much more than the nominal spread, mainly because the increase in super-long JGB yields is larger than the increase for the yield on the benchmark. Even though conservative, it is uncomfortable to have a negative OAS, which is the expected value of excess returns relative to government bonds. That said, this is only an estimate based on one model and those who expect long-term JGB yields to rise may find RMBS investment attractive because of the expectations for total returns exceeding the coupon rate due to reinvestment of the principal amount of RMBS that will be partially redeemed

Chart: Issuance Terms for JHF Monthly MBS

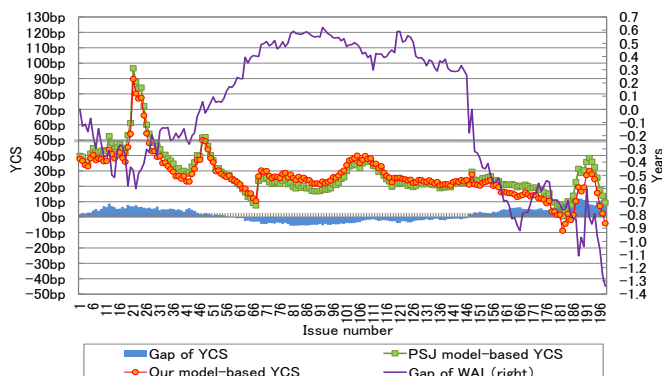


Source: JHF and our estimates. Note: The background colors indicate different fiscal years.

Different risk premiums depending on expected cash flow distribution

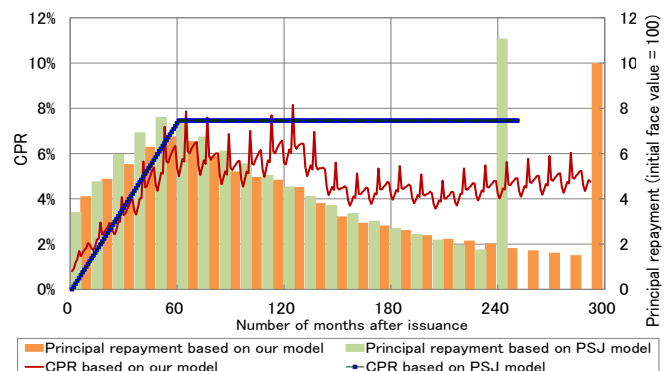
With regard to the pricing of JHF MBS, it should be noted that the risk premium varies depending on the expected cash flow distribution. A recent trend has been for monthly new bond issuance to assume a longer cash flow distribution in our prepayment forecast model than in the PSJ model's view using PSJ forecast statistics. As such, recently the YCS measured at the time of new bond issuance tends to be smaller in our model due to the positive yields.

Chart: Difference in YCS for Monthly MBS at Launch



Source: Our estimates.

Chart: Expected CPR & Principal Repayment for No. 199 Issue (based on 10 November closing prices)



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

Cash flow characteristics and issuance terms for No. 199

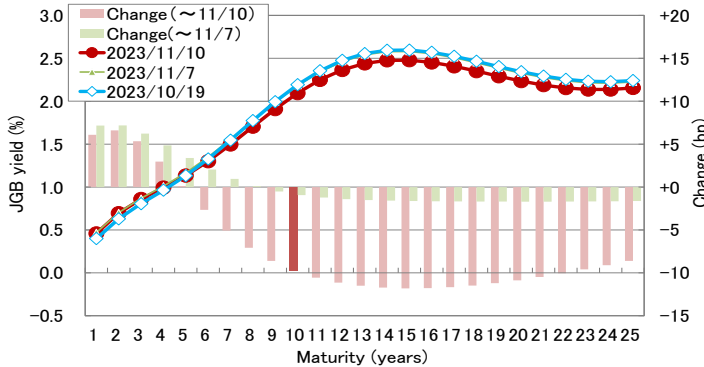
We take a look at the issuance terms for the upcoming issue. Based on expected cash flow using our prepayment model and the PSJ model, we estimate the issuance terms (the coupon and launch spread) and the risk premiums.

Expected maturity of 10 years

The expected cash flow distribution for the upcoming issue (the chart on the previous page, based on 10 November 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 10.85 years (11.02 years for the previous issue) and the expected final maturity 24.4 years (24.5 years). The PSJ forecast is 5.69% (vs. 5.56% for the previous issue).
- The PSJ Calculation Statistical Value (average) is 7.46% (vs. 7.42% for the previous issue). Accordingly, the expected WAL is 9.63 years (vs. 9.68 years for the previous issue) and the expected final maturity 20.9 years (21.0 years).

Chart: Change in 3Y-Forward Rate (from the day before launch day of No.198)



The expected maturities shortened slightly compared to those for the previous issue. This is because the WAC (home loan weighted average coupon) and WAC' were 1.58% and 1.36%, respectively, 0.07pt higher than the previous bond (see pp. 6-7), while forward rates declined overall. Especially for medium-term and longer maturities, the refinancing rate for each future period assumed from the forward rate is decreasing. As such, this will lower the incentive to refinance (= WAC' – refinancing rate) in each future period thereby increasing the prepayment forecasts.

Source: JHF; compiled by Daiwa Securities.

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

Chart: Launch Spread Estimates for No. 199 MBS (based on 10 November closing prices)

Valuations of JHF_MBS_#199 Pricing(Simulation)									10-Nov-23 (Tokyo Close)
Base Yield: JGB(372G) YTM 0.848 %									
Launch Spread	Coupon	Valuations of Cash Flows							Indications of Previous RMBS Issue (#198)
		Daiwa Model				PSJ Model			
		Dynamic	Static			PSJ forecast Statistical Data(Ave)			
		OAS	YCS	ASW	ModDur	YCS	ASW	ModDur	
28 bp	1.13 %	-14.8	-6.6	-11.3	9.847	5.1	-3.6	8.861	(Issuance Terms)
29 bp	1.14 %	-13.8	-5.5	-10.3	9.838	6.1	-2.6	8.854	Launch Spread=34bp
30 bp	1.15 %	-12.7	-4.5	-9.3	9.830	7.2	-1.6	8.847	Coupon=1.18%
31 bp	1.16 %	-11.7	-3.4	-8.3	9.821	8.2	-0.7	8.841	(Valuations at the time of Launch)
32 bp	1.17 %	-10.6	-2.4	-7.3	9.812	9.2	0.3	8.834	[CF based on Daiwa Model]:
33 bp	1.18 %	-9.6	-1.3	-6.3	9.803	10.3	1.3	8.827	OAS=-11.9bp, YCS=-4bp, ASW=-9.7bp
34 bp	1.19 %	-8.5	-0.3	-5.4	9.794	11.3	2.3	8.820	[CF based on PSJ Model]:
35 bp	1.20 %	-7.4	0.8	-4.4	9.786	12.4	3.3	8.814	YCS=9.4bp, ASW=-0.5bp
36 bp	1.21 %	-6.4	1.8	-3.4	9.777	13.4	4.3	8.807	(Valuations in the secondary market)
37 bp	1.22 %	-5.3	2.9	-2.4	9.768	14.4	5.3	8.800	[CF based on Daiwa Model/Daiwa Price]
38 bp	1.23 %	-4.3	3.9	-1.4	9.759	15.5	6.2	8.793	OAS=-10bp, YCS=-1.9bp, ASW=-6.7bp
39 bp	1.24 %	-3.2	5.0	-0.4	9.750	16.5	7.2	8.786	[CF based on PSJ Model/JSDA price]:
40 bp	1.25 %	-2.1	6.0	0.6	9.742	17.6	8.2	8.780	BEY=1.179%, YCS=9bp, ASW=0.5bp
41 bp	1.26 %	-1.1	7.1	1.5	9.733	18.6	9.2	8.773	
42 bp	1.27 %	0.0	8.1	2.5	9.724	19.6	10.2	8.766	
		<Daiwa Model>			<PSJ Model/based on PSJ Forecast Statistical Data>				
		PSJ	5.69 %		Ave: 7.46 %		(Median: 7.80) %		
		WAL	10.85 years		9.63 years		(9.42) years		

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.

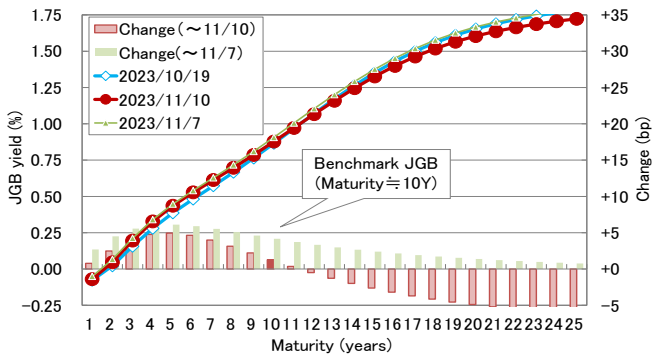
3) Estimated cash flow is based on the assumption that clean-up call options are exercised in initial April or October after the outstanding amount becomes 10% or less of the original.

Launch spread indications

The previous issue (No. 198) was launched at a time when the yield to maturity for the on-the-run 10-year JGB rose above the 0.80% level. Since then, the yield on the on-the-run has tested further upside, moving closer to 0.90%.

Assuming a launch spread of 34bp, the same as the previous issue's, the No. 199's coupon would be 1.19%, 1bp larger than the previous issue. In that case, based on

Chart: JGB Yield Curve Changes (from the day before launch day of No.198)



Source: Compiled by Daiwa Securities.

estimated cash flows using the average PSJ forecast, the YCS would be 11.3bp, 1.9bp higher than 9.4bp at the time of previous issue's launch. Based on our model, the OAS would be -8.5bp, 3.4bp higher than the OAS of -11.9bp at the time of the previous issue's launch (based on the 10 November close).

OAS and YCS change even when the launch spread does not change. This is because the JGB yield curve does not move in a parallel manner with exactly the same magnitude as the change for the on-the-run 10-year JGB yield. YCS and OAS expand when yields on other maturities decrease relative to the on-the-run 10-year JGB yield.

Secondary market prices

The connections between the previous issue and the upcoming one are as follows (secondary market prices and base rates are as of the 10 November close). For the price of the on-the-run issue in the secondary market, we use the retail mid-rate as well as the risk premium in the JSDA's Reference Statistical Prices [Yields] for OTC Bond Transactions.

(Connection with risk premium of previous issue)

【Pricing using our model's cash flow estimates】

- The No. 198's launch OAS was -11.9bp and the YCS -4.0bp. Based on the similar OAS and YCS, the No. 199's launch spread would be 30-31bp and the coupon 1.15%~1.16%.
- In the secondary market, the previous issue's BEY (estimated yield to maturity) is 1.177%, OAS is -10.0bp, and YCS is -1.9bp based on our mid-rate (Y100.04). Based on the similar OAS and YCS, the No. 199's launch spread would be 32-33bp and the coupon would be 1.17%~1.18%.
- In the secondary market, the previous issue's BEY would be 1.179%, OAS would be -9.8bp, and YCS would be -1.7bp based on the reference statistical price (Y100.02). In line with this, the No. 199's launch spread would be about 33bp and the coupon would be 1.18%.

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

- The No. 198's launch YCS was 9.4bp. Based on the similar YCS, the No. 199's launch spread would be about 32bp and the coupon 1.17%.
- In the secondary market, BEY is 1.179% and YCS is -1.7bp based on the reference statistical price (Y100.02). This would mean the upcoming issue will have a coupon of 1.18% and a launch spread of 33bp.

(Demand forecast for No. 199 issue and issuance level)

Maximum issue size Y50.0bn

This time an issuance amount of around Y50.0bn at the most, down roughly 40% y/y, is expected. The issuance could be reduced further if investment demand is insufficient.

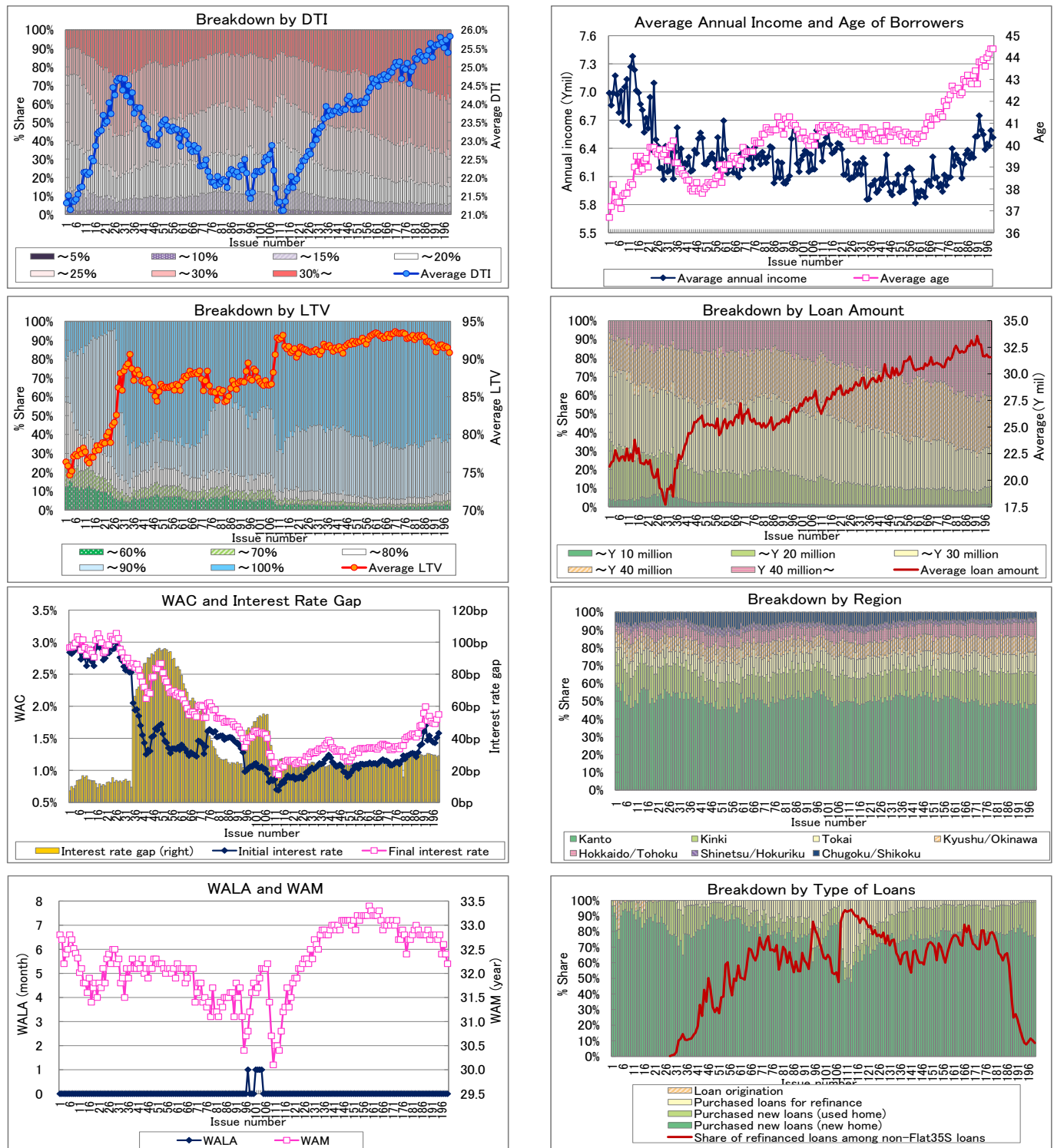
For the time being, variable-rate loans will be very appealing to those taking out home loans, as interest rates are likely to be suppressed as the BOJ maintains its negative policy rate. As such, Flat 35 usage is unlikely to grow and RMBS issuance may remain weak. Home prices have already bottomed out and the growth of home acquisition itself has been suppressed. The continued housing market sluggishness, which has a large ripple effect on the overall economy, seems to be an unfortunate state of affairs that can easily prevent

broad-based wage growth. If the supply of low-interest mortgages were to act as the brake for those conditions, we could probably expect the suppression of the RMBS coupon and the Flat 35 interest rate, along with the expansion of policy-based interest rate incentives in order to realize a virtuous cycle in the economy.

Coupon rate in upper 1.10% range

The personal opinion of your author is that the launch spread for this issue will confirm sufficient demand and be either 32-34bp. In this case, the coupon would be 1.17-1.19% (based on 10 November closing prices).

Characteristics of Underlying Loan Pools for All JHF Monthly MBSs



Source: JHF; compiled by Daiwa Securities.
 Note: Candidate pool used for No. 199 issue.

Characteristics of Underlying Loans: No. 199 Monthly MBS and Last Six Issues (No. 193-198)

	JHF #193	JHF #194	JHF #195	JHF #196	JHF #197	JHF #198	JHF #199	Ave. of previous 6 issues	Change from #198	
Loan Pool Selected in	Apr-2023	May-2023	Jun-2023	Jul-2023	Aug-2023	Sep-2023	Oct-2023			
Loan Application Started in	Oct-2020	Jan-2021	Jun-2020	Mar-2021	Mar-2021	May-2021	Nov-2020			
Repayment Started in	Apr-2023	May-2023	Jun-2023	Jul-2023	Aug-2023	Sep-2023	Oct-2023			
Initial Outstanding Entrusted Assets (Y mil)	84,455	76,898	89,867	79,410	81,718	78,608	69,662	81,826	-8,946	
Issue Size (Y mil)	66,900	60,900	71,600	62,800	64,500	61,900	TBD	64,767	-	
Excess Collateral (Y mil)	17,555	15,998	18,267	16,610	17,218	16,708	TBD	17,059	-	
Overcollateralization	20.7%	20.8%	20.3%	20.9%	21.0%	21.2%	TBD	20.8%	-	
Number of Loans	2,572	2,348	2,837	2,510	2,568	2,490	2,207	2,554	-283	
Average Outstanding Loan (Y mil)	32.836	32.750	31.677	31.638	31.822	31.570	31.564	32.049	-0.005	
Average LTV	91.52%	91.87%	91.88%	91.48%	91.68%	91.54%	90.84%	91.66%	-0.70%	
Average DTI	25.60%	25.80%	25.67%	25.52%	25.73%	25.39%	25.83%	25.62%	+0.44%	
Average LTV for Refinance	67.52%	66.29%	66.77%	68.06%	66.40%	57.49%	65.63%	65.42%	+8.14%	
Average DTI for Refinance	19.89%	20.44%	20.48%	19.46%	17.97%	18.72%	19.62%	19.49%	+0.90%	
Average Annual Income of Obligor (Y mil)	6.592	6.546	6.386	6.447	6.426	6.589	6.514	6.498	-0.075	
Average Age of Obligor	43.8	43.9	43.6	44.1	44.2	44.4	44.4	44.0	+0.0	
WAC (Initial Rate)	1.47%	1.54%	1.47%	1.44%	1.43%	1.51%	1.58%	1.48%	+0.07%	
WAC (Final Rate)	1.78%	1.84%	1.77%	1.74%	1.73%	1.80%	1.87%	1.77%	+0.08%	
WALA (Weighted Average Loan Age)	0	0	0	0	0	0	0	0	+0	
WALA for Refinance	140	159	137	170	148	152	155	151	+3	
WAM	394	392	394	389	391	389	386	391	-2	
Maturity Structure of Loans at Origination (% share)	Up to 10Y	0.3%	0.1%	0.1%	0.1%	0.1%	0.2%	0.1%	0.1%	-0.0%
	10-20Y	5.8%	6.8%	6.5%	8.1%	7.9%	8.5%	9.5%	7.3%	+1.0%
	20-25Y	3.8%	3.3%	3.5%	3.3%	3.1%	2.9%	3.2%	3.3%	+0.3%
	25-30Y	7.1%	7.5%	6.8%	7.8%	7.2%	7.6%	7.7%	7.3%	+0.2%
	Over 30Y	83.0%	82.3%	83.2%	80.7%	81.7%	80.8%	79.4%	81.9%	-1.4%
% share of loans with bonus payments	(in number)	6.7%	5.4%	5.7%	5.9%	5.6%	6.3%	5.5%	5.9%	-0.8%
	(in value)	7.4%	6.1%	6.7%	6.6%	6.2%	7.0%	6.0%	6.7%	-1.0%
Type of Loan	new	98.8%	99.0%	99.1%	98.9%	98.7%	98.9%	99.0%	98.9%	+0.1%
	refinanced	1.2%	1.0%	0.9%	1.1%	1.3%	1.1%	1.0%	1.1%	-0.1%
Loan Amount at Origination (% share)	Up to Y10 mil	1.1%	1.0%	1.3%	1.4%	1.1%	1.5%	1.3%	1.2%	-0.2%
	Y10-20 mil	7.9%	8.1%	8.6%	9.4%	9.3%	9.1%	9.6%	8.7%	+0.5%
	Y20-30 mil	19.7%	19.9%	20.8%	20.9%	21.6%	21.2%	21.8%	20.7%	+0.6%
	Y30-40 mil	27.9%	29.9%	31.7%	28.6%	27.6%	27.8%	26.8%	28.9%	-1.0%
	Y40-50 mil	21.5%	19.7%	17.9%	19.0%	19.0%	21.2%	20.2%	19.7%	-1.0%
	Over Y50 mil	22.0%	21.3%	19.7%	20.7%	21.3%	19.3%	20.3%	20.7%	+1.0%
Loan Amount by Region (% share)	Hokkaido/Tohoku	8.8%	7.1%	8.1%	6.7%	7.9%	7.3%	9.8%	7.6%	+2.5%
	Kanto	46.1%	49.1%	45.6%	48.1%	48.0%	48.7%	48.1%	47.6%	-0.6%
	Shinetsu/Hokuriku	2.4%	1.5%	1.6%	2.8%	2.0%	2.3%	2.0%	2.1%	-0.3%
	Tokai	9.6%	10.0%	10.0%	11.1%	11.0%	11.4%	11.1%	10.5%	-0.2%
	Kinki	18.8%	17.5%	19.6%	18.4%	18.6%	17.5%	16.6%	18.4%	-0.9%
	Chugoku	2.8%	2.8%	3.1%	2.3%	1.8%	2.7%	1.9%	2.6%	-0.8%
	Shikoku	1.3%	1.1%	1.3%	1.1%	1.6%	1.2%	1.4%	1.3%	+0.2%
	Kyushu/Okinawa	10.3%	10.9%	10.7%	9.4%	9.0%	8.9%	9.1%	9.9%	+0.2%

Source: JHF; compiled by Daiwa Securities.
Note: Candidate pool used for No. 199 issue.

IMPORTANT

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- 1: Outperform TOPIX/benchmark index by more than 15% over the next 12 months.
- 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.

Benchmark index: TOPIX for Japan, S&P 500 for US, STOXX Europe 600 for Europe, HSI for Hong Kong, STI for Singapore, KOSPI for Korea, TWII for Taiwan, and S&P/ASX 200 for Australia.

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(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

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