



Arbitrage opportunities

With the end of the Bank of Japan's monetary easing policy, the Japanese market is moving towards normalisation and garnering attention from global investors, says Japan Securities Finance's Kohei Takeda and Kenta Yamamoto

What are JSF's primary business lines?

Takeda: Japan Securities Finance Co was established in 1950 as a specialised institution for securities finance. JSF is the only securities finance company in Japan

licensed under the Financial Instruments and Exchange Act, operating loans for margin transaction (LMT). Our main business has been LMT since the founding, which is a critical infrastructure for Japan's securities and financial markets.

Additionally, JSF focuses on fixed income repo for Japanese government bonds (JGBs) and government-guaranteed bonds, stock lending for Japanese equities, and equity repo for funding and collateral upgrade by accepting various securities and providing high-quality liquid assets (HQLAs) such as JPY, USD, and JGB.

We refer to these operations as our security finance business, one of our growth engines.

What are the latest trends in JGB repo? What role does JSF play in this market?

Yamamoto: The BOJ revised its negative interest rate policy in March 2024 and subsequently implemented two rate hikes by the end of January 2025. As of January 2025, the policy interest rate stands at +0.5 per cent (BOJ will encourage the uncollateralised overnight call rate to remain at around +0.5 per cent).

The repo rates in the JGB repo market (JGB versus JPY transactions) are determined based on the central bank's policy rates similar to other European and US countries, and therefore influenced by the policy changes. Under the previous yield curve control (YCC) policy, the repo rates often fell below the policy rate due to high demand for JGB.

However, with the termination of YCC and a reduction in BOJ's bond purchases, the demand-supply balance of JGB has improved, reducing the divergence from the policy interest rate and volatility of JGB repo rates.

Under such circumstances, JGB repo market transactions grow steadily in both general collateral (GC) and special collateral (SC) transactions, and the outstanding of the JGB repo market stands around 250 trillion yen with the continuous rise in JGB issuance as a background.

On the other hand, outside of Japan, there remains strong speculation about further changes in the BOJ's monetary policy. As a result, the need for short trades and their covering, particularly by hedge funds and other entities, remains high, leading to a continuous shortage of JGB. There are many arbitrage opportunities in the JGB market.

For example, under the Bank of Japan's YCC, there were trades targeting discrepancies among the JGB cash market, the interest rate swap market, and the JGB futures market caused by BOJ's large purchases of JGB with specific maturities.

Similarly, arbitrage opportunities arise from supply and demand discrepancies in specific issues. The smoothness of borrowing and lending JGB in the JGB repo market is crucial for timely execution of these arbitrage trades. Therefore, the JGB repo market continues to be highly attractive for all market participants, both domestically and internationally.

**“The JGB
repo market
continues to be
highly attractive
for all market
participants, both
domestically and
internationally.”**

In the recent JGB repo market, there has been a notable rise in spread trading that achieves a neutral cash position by combining SC transactions for borrowing specific JGB with cash and GC transactions for borrowing cash with JGB collateral. This method has gained significant attention in recent years, as it enables market participants to effectively offset interest rate risk, credit risk, and other risks through reverse transactions.

As a leading entity in the JGB repo market, we have covered nearly all financial institutions and institutional investors in Japan. Within this framework, we have also come to play a pivotal role as a hub between the domestic and international repo markets, facilitating the flow of domestic liquidity

to global markets. In addition to regular SC and GC transactions, we are actively engaged in the aforementioned spread trading. Our network of overseas counterparties continues to expand, allowing us to accumulate a wealth of insights and solutions. Our international partners often note that trading with us provides direct access to JGB market liquidity. They also value the ability to obtain real-time pricing across various issues, significantly enhancing their JGB trading capabilities.

“As a leading security finance institution in Asia, we will connect the rapidly growing Asian markets with global markets.”

Furthermore, there is a growing trend of cross-currency repo, borrowing USD and other currencies with JGB in Japan. The demand varies in scale depending on the financial institution; nonetheless, foreign asset managers outside of Japan can operate USD and other currencies at competitive levels while significantly reducing their administrative costs.

Transactions of bonds other than JGB, such as public bonds (government-guaranteed bonds and municipal bonds) and corporate bonds, remain limited. However, there is a growing demand, particularly from overseas, for borrowing or lending cash with various bonds. We are dedicated to pioneering these new transactions and expanding market opportunities. We will further commit to aggregate comprehensive information on various bonds and propose diverse transaction solutions tailored to each need from our clients.

What current trends are you seeing in the lending market for Japanese stocks? What role does JSF play in this market?

Takeda: Despite several interest rate hikes by BOJ, the Japanese stock market has continued to grow steadily. In this circumstance, for Japanese stock-lending transactions, there has been no change in the relationship between GC rates and the policy interest rate in a rising interest rate environment. From the lenders' perspective, they typically need to pay the collateral money rate for unsecured overnight call transactions, but as they operate the received collateral money in unsecured call markets, the impact of rate hikes is limited.

On the other hand, borrowers are compressing their inventories due to the increased cost of collateral money procurement and are showing a preference for securities collateral over cash. Some major lenders who previously only accepted cash collateral have started to accept securities collateral as well. Additionally, with the Tokyo Stock Exchange's extension of trading hours in November (from 15:00 to 15:30), company announcements become published after 15:30, leading to a delay in lending inquiries.

In this environment, we are responding to the increasing demand for securities collateral and continuing to minimise fail risks through fail cover transactions, contributing to the development and stability of the market. Since 2023, a new listing of active ETFs has led to an increase in funds with different stock composition and weightings from the main index, introducing many stocks which are not included in the main index to enter the market. With our high credit ratings (S&P short-term credit rating A-1, long-term credit rating A) and solid operations, we aim to establish a trading framework with these funds to incorporate new stocks into the lending market, enhancing its depth.

What are some of JSF's initiatives for the business globally outside of Japan?

Yamamoto: JSF has focused on the Japanese market since its founding. With the extensive insights

accumulated on domestic security finance operations over the years, we extended our business in recent years and are actively trading with overseas clients including global systemically important banks (G-SIBs) in equity repo. During this period, we have consistently participated in international conferences to expand our clients. These initiatives have enhanced our overseas operations, achieving our recognition as the 'Asian Repo Team of the Year' at the Securities Finance Industry Excellence Awards in 2024. Our clients now extend across Asia, Europe, and the US.

Within this international framework, we have identified the Asian market as a strategic target for further growth, given its geographical proximity and dynamic market potential. The stock markets across Asia have diverse regulations and characteristics. In Taiwan for example, the interdealer market restricts the number of brokers capable of handling transactions.

Recognising Taiwan as a high-growth market with limited competitors, we developed our own scheme in 2017 and entered this market. Transaction volumes have been steadily increasing since the beginning.

Beyond Taiwanese stocks, we started a funding business for Hong Kong stocks in 2022 and are actively preparing to launch a funding business for Korean stocks in 2024. We are also preparing to meet funding needs for assets such as Indonesian government bonds.

We collaborate with triparty collateral management services, which enable seamless adaptation to local regulations and market characteristics at a low cost without local offices.

In response to borrowing Asian assets, we provide JPY and JGB as HQLA, effectively addressing the liquidity coverage ratio (LCR) and net stable funding ratio (NSFR) regulatory requirements of G-SIBs financial institutions. With JSF's high credit ratings, we can procure JPY and JGB on advantageous terms.

We will continue to make the most of the unique strengths of our business model, flexibly

incorporating new assets, regulatory frameworks, and transaction schemes. As a leading security finance institution in Asia, we will connect the rapidly growing Asian markets with global markets and contribute to the overall development of the financial market. ■

Kenta Yamamoto
Vice president of fixed income repo
Japan Securities Finance



Kohei Takeda
Senior vice president of equity repo
Japan Securities Finance

