



Photo by Yasuhiro Imamiya

## Japan Markets Bloom

### Topics of the month

JPX Derivatives Markets Integration and Next Generation System

HKEx and LME Update

### Regulatory news

METI To Revitalize Commodity Markets in 2014

Government Appointed Panel for Vitalizing Financial Markets

### People Interview

Toshihide Endo,

“FSA Toshihide Endo Discusses Regulations and Plans to Develop Japan’s Position as the Asia Financial Center”



Toshihide Endo

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## FIA Japan “Mission”

Mitch Fulscher, Chairman, FIA Japan

Our Association was formed over 25 years ago by a small group of futures brokers and financial market leaders who were involved with the new derivatives markets introduced into Japan in the 1980s. At that time, the regulations and authorizations were obscure and not directly applicable to these new financial products, particularly to those introduced from overseas. The segregation of the marketplace into “silos” by product-type made it extremely difficult to resolve issues related to these markets. FIA Japan quickly became the only association where the various members of the futures industry could come together and share information about both the domestic markets and the overseas futures markets coming in to Japan. At that time our primary activity related to sharing information about the products, and the issues relating to the interpretation of the rules and regulations, among market participants across the silos. However, over time, we began to directly interface with the various Japan regulators and exchanges, and to offer information and views about practices overseas and issues related to operations in Japan. We developed viewpoints, shared them with the exchanges and the regulators, and offered public forums for education.

From this small group of Japanese and foreigner members, we grew over the years to represent the full spectrum of the marketplace in Japan. Today our 60 corporate members represent Japanese and overseas global exchanges and investment banks and brokers as well as the service providers to the industry operating in Japan.

### Government Focus on Financial Market –

As a part of the Prime Minister’s “third arrow” of reform, the Japan Government initiated a program focusing on the financial markets. They are taking action to develop Japan as the Financial Center for Asia. Actions along these lines include the amendments to the Laws and Regulations breaking down the regulatory silos and helping to eliminate existing roadblocks to the growth of this industry. Several articles in this edition of our newsletter highlight these developments and include comments by senior officials from FSA and METI as well as a special report by a Government appointed panel on revitalizing the financial markets.

### FIA J Expanding Activities and Mission –

In the past year our activities have grown with the addition of new members of the Board representing major financial institutions. The members of our new committees are extremely busy and we have been interacting directly with the regulators and exchanges responding to questions and issues related to growing the financial market and enhancing efficiency. There are also many new issues facing the markets as a result of the Dodd Frank and European extraterritorial reach which we have been addressing. In addition, we are reaching out to our members with a series of seminars on a variety of financial market issues. These activities are consistent with the Government’s initiatives, and they are in-line with our own “mission” as stated in our Articles of Incorporation – “to promote Japan as a regional and global financial center with a focus on derivatives.” This is a challenging goal. Now is the time for FIA J, and for Japan.

# “FSA Toshihide Endo Discusses Regulations and Plans to Develop Japan’s Position as the Asia Financial Center”



**Toshihide Endo**

Deputy Director-General, Planning and Coordination Bureau,  
Financial Services Agency, Japan

Mr. Toshihide Endo is a Deputy Director-General of the Planning and Coordination Bureau, where he is responsible for overall planning and policy making of financial system, planning and policy making concerning securities markets and other financial markets, monitoring and analysis of these markets and supervision of exchanges.

From July 2010 to June 2013, Mr. Endo was the Deputy Director-General of the Supervisory Bureau, where he was responsible for supervising banks, broker-dealers, insurance companies and Deposit Insurance Corporation of Japan. From 2009 to July 2010, Mr. Endo was the Director of the Commissioner’s Secretariat, where he was in charge of human resources development as well as budgetary and policy coordination of the agency. Prior to his posting to the FSA, Mr. Endo worked for the Asian Pacific Department and Finance Department of the International Monetary Fund. Mr. Endo received a B.A. in Law from the University of Tokyo in 1982 and a M.Sc. in Economics from LSE in 1986.

**FIAJ:** The Government’s Growth Strategies give much focus to the importance of further developing Japan’s financial market. FSA is playing an important role under this mandate. What are some of FSA’s initiatives going forward to help to position Tokyo as a Regional/Global financial center?

Based on the “Japan Revitalization Strategy” issued last June, the “Panel for Vitalizing Financial and Capital Markets,” which was jointly held by FSA and MOF, released on December 13, 2013, recommendations from a mid-term point of view to consider a growth strategy in the financial field, proposing where the Japanese markets ought to be by 2020. Taking into account the changing internal and external economic and social structure, such as Asian countries’ rapid growth and the decreasing birthrate/aging population [in Japan], these recommendations set the goal for Japan to become Asia’s number one international financial center by 2020. A listing of a number of issues to be tackled include the following: improve the use of the abundant household financial assets, through schemes such as the Individual Savings Account (NISA) introduced in

January; promote entrepreneurship and new ventures by establishing crowdfunding and removing burdensome requirements for new listings.

We will work aggressively to improve the attractiveness of Japan’s financial and capital markets, in order to establish our position as an international financial center.

*“We will work aggressively to improve the attractiveness of Japan’s financial and capital markets, in order to establish our position as an international financial center”*

**FIAJ:** Globalization of the markets through cross-border mergers/affiliations of exchanges has been an important movement taking place in Europe and the US. More recently this is developing in Asia. What is your view about

this with respect to the Japan markets?

After 2000, large-scale integration and reorganization of European and American exchanges were announced, including the creation of Euronext through the integration of three European markets in 2000, followed by the combination of NYSE Group and Euronext in 2007, and ICE's acquisition of NYSE Euronext in 2013. More recently, exchange consolidation is occurring in Asia, as shown by HKEx's announcement of its acquisition of LME last June.

In Japan, TSE and OSE merged in January last year forming JPX group. JPX group integrated its capital stock markets last July, and the integration of its derivatives markets is scheduled this March. The integration or reorganization of exchanges overseas has resulted in the creation of "comprehensive exchanges" listing a wide array of financial products, such as equities, financial derivatives and commodity derivatives, while in Japan, the Financial Instruments and Exchange Act (FIEA) was revised in 2012 setting a framework for the establishment of such a comprehensive exchange.

In order to improve the attractiveness of the markets and broaden the range of investors, FSA will encourage related parties, such as the exchanges, and work to implement the revised FIEA towards the early realization of a comprehensive exchange.

**FIAJ: The regulators in Japan have been criticized in the past as being overly "restrictive" in their approach to regulation and surveillance. We understand that FSA is now moving to a "principle-based" approach. Please give us an update on how this is changing in Japan.**

Having engaged in an initiative to improve the quality of financial regulation ("better regulation"), FSA presented an optimal combination of rule-based and principle-based supervisory approach as one of its specific pillars in 1997.

With regards to the principle-based supervision, FSA set the "Fourteen Principles for the Financial Services Industry" in April 2008, working to enrich dialogue and share these principles with financial institutions to encourage them to produce better results. These principles are a guide for both the regulator and the financial instruments operators when deciding on the suitability of any event that isn't covered by a specific rule.

The supervisory policy this fiscal year is fundamentally aimed at further deepening said better regulations: have candid and in-depth dialogue with financial business operators, disseminate information abroad, share information and cooperate on financial and economic aspects both in and out of Japan, and increase the transparency and predictability of regulatory actions. Since implementing only rigid regulations may cause distortion and over-regulation, resulting in a negative impact on the real economy, the FSA is also aiming to achieve a high-quality supervisory administration, while reducing regulatory costs in the medium-to-long term, assuming that the financial institutions' self-discipline will improve and that the regulator's supervisory capacity will also improve.

**FIAJ: "High Frequency Trading" is getting much attention by regulators and others in the global markets. What is the situation in Japan? Does FSA have a view on this activity?**

Recently, electronic trading has been increasing in the Japanese stock market, as shown by the fact that the ratio of trading orders on TSE originating from a co-location service has increased from 23.2% in 2010 to 57.8% in 2013, and the amount of trades relying on

***"FSA will work towards the early realization of a comprehensive exchange"***

***"Since implementing rigid regulations may cause distortion and over-regulation ... the FSA is also aiming to achieve a high-quality supervisory administration, while reducing regulatory costs"***

***"there are various views on the influence of HTF on the market, so we need to carefully observe market conditions"***

high-technology is expanding.

I recognize that there are various views on the influence of HTF on the market, so we need to carefully observe market conditions and, for example, check whether a large amount of orders placed in a short amount of time could lead to a distortion in price formation.

**FIAJ: Extra-territorial outreach resulting from Dodd-Frank and EU regulations are creating havoc for global market players in many countries. How do you see things unfolding in Japan? Are there issues arising here?**

In general, the regulations of another country should be respected, but when dealing with cross border transactions, if a particular country extends its regulations beyond its own borders, it should first assess the other country's equivalence to avoid overlapping regulations. If the foreign regulatory framework is equivalent, it should rely on their regulations and supervision. Furthermore, if a particular country applies its own regulations to foreign players, the details of these regulations should be made clear and, when needed, an appropriate transition period/measures must be in place in order to avoid causing havoc amongst market players.

***“if a particular country extends its regulations beyond its own borders, it should first assess the other country's equivalence to avoid overlapping regulations”***

FSA is currently going over the equivalency assessment of OTC derivatives regulations with European and US regulators, while stressing that the final assessment should be made on the overall “regulatory outcome” (rather than on a rule-by-rule comparison) based on international standards, such as the CPSS-IOSCO Principles for Financial Market Infrastructure. Finally, Japanese CCPs are applying for reg-

istration with the CFTC as derivatives clearing organizations (DCO), as well as applying for recognition by ESMA. FSA will continue to pay close attention to these matters in order to avoid any negative impact on transactions conducted by Japanese market participants.

**FIAJ: Thank you for your candid and comprehensive responses. FIAJ looks forward to continue its collaboration with FSA to help develop the Japanese markets.**

## Regulatory News

### METI To Revitalize Commodity Markets in 2014

At a commodity futures industry New Year's party held on January 6th in Tokyo, Mr. Tatsuya Terazawa--METI Director-General for Commerce, Distribution and Industrial Safety Policy--shared his position that the government should work hand-in-hand with the industry to revitalize the stagnating commodity futures markets. Mr. Terazawa stated that “It is essential for the commodity industry and the exchanges to be trusted by the public. To achieve this goal, all of us gathered today, METI, MAFF, associations and exchanges must work closely together.”

From a policy view point, he reaffirmed the importance of commodity markets, commenting that “The energy issues faced by Japan are serious and the commodity futures markets play an important role in resolving these issues”, also clarifying a policy to submit a proposed amendment to the Commodity Exchange Act (CEA) to allow the listing of electricity futures at the next ordi-

nary session of the Diet. With regards to the listing of LNG futures--a commodity that is an important source for energy--he noted that "It may not happen right away, but we will move forward with implementation."

On the other hand, after having confirmed that he understands the industry's wishes to stop the market stagnation and relax solicitation rules, Mr. Terazawa said: "To revive our markets, we must reach out to various investors both in and out of Japan. In order to do this, we must tackle a number of issues, including accounting rules over bona fide hedging, taxation, and also we need to relax rules governing pension funds investments and solicitation. However, consumers also have opinions with regard to solicitation rules. Relaxing solicitation rules is not a "magic wand". Market stagnation started before these rules were introduced, so even if they were to be relaxed, we won't come back to the levels we were at 10 years ago. A single magic wand won't do the trick. We rather need a more comprehensive set of actions if the commodity futures markets are to play their role as a public utility. The plan to relax solicitation rules is underway, but what will be essential then is whether or not retail investors and the general public trust the commodity futures industry and the exchanges."

The proposed amendment to the CEA, which include the solicitation rules relaxation, is scheduled to be made public in March, so it isn't yet clear what modifications will be included.

### **Government Appointed Panel for Vitalizing Financial Markets**

A panel of financial experts, including JPX CEO Saito and Tokyo University Professor Takatoshi Ito, released their report last December titled "Recommendations for Vitalizing Financial and Capital Markets." Working in collaboration with FSA, the Ministry of Finance and the Bank of Japan, the Panel focused on the importance of developing Japan into the regional financial center for Asia. They note that the derivatives markets including commodities must be further developed emphasizing that specific regulations and rulings must be eased.

The report conclusion is that for the Tokyo market to develop into a global financial center "Japan's operations cost, living environment, regulations and the tax system needs to be improved to make Tokyo competitive." The Panel will continue in place in order to embody specific measures for action.

## **Topics of the Month**

### **JPX Derivatives Markets Integration and Next Generation System**

The derivatives markets of the Osaka Securities Exchange (OSE) and Tokyo Stock Exchange (TSE) are to be integrated on March 24, 2014.

The integration should provide instant synergies, consolidating all the derivatives products of JPX under a single market and a single trading platform (the current OSE system, J-GATE), so that all the futures and options contracts currently listed on TSE will move onto OSE. The current OSE trading rules will be applied to all futures and options contracts, with the exception of JGB Futures/Options where the current TSE rules will generally continue to apply. Circuit Breakers and Daily Price Limits will be revised. The trading hours will be aligned with the ones for OSE, so that the night session for futures and options contracts currently listed on the TSE market will be extended to 3:00 a.m. the next day.

On the day of integration, a Yen-dominated futures contract based on CNX Nifty, which is a major Indian stock index, will be launched. In addition, the launch of a newly designed 20-year JGB futures is scheduled on April 7, 2014 (the contract had been suspended since 2002). Upon integration of its derivatives market, JPX will have completed its reorganization following the establishment of a holding company (Jan 2013), the integration of the cash markets (Jul 2013), etc.

Click here for a complete product list of the integrated market: <http://www.ose.or.jp/e/profile/7030>



In parallel, JPX announced in a February 4 statement that it has opened submission of proposals for its next generation derivatives trading system to solutions providers capable of meeting its goals and criteria. According to the notification, the new trading system will be aimed at producing a highly convenient and globally competitive system which will serve the derivatives market for the medium-to-long term. JPX hopes to launch the new system in 2016.

## Tokyo Olympics and its Impact on Japan

By Chika Nakamura, ABN Amro Clearing

The purpose of the Olympics is a festival of sportsmanship and a cultural exchange. However, it will also influence the economy. Indeed, there are always pros and cons to the economic effect of the Olympics. Nevertheless, it is an opportunity for “change” and for Japan to improve its infrastructure and living standards. The Abe cabinet has stated the following goals in its Japan Revival Strategy: Tokyo to rank within the world’s top 3 cities for ‘living environment’, increase the number of foreign visitors to Japan to over 30 million [from 10 million in 2013], and rank as the top hosting country in the Asian region for international meetings and conventions.

Similar to FIAJ’s submission of a “wish list” for the improvement of market participation, there should be a wish list made to the Olympic committee on how to achieve even better results, which could be enjoyed after the actual event as well. What we need is a user friendly environment to bring more participation and for Tokyo to be in the world’s spotlight. For example:

1. Extend the hours for public transportation
2. Bring about more competition in the oligopolistic industries

As with the OSE night session extension that helped attract new participants and changed the dynamics of the market, resulting in a significant increase in trading volume, the extension of operating hours for public transportation will not only facilitate movements but also stimulate the economy between peripheral areas and the center of Tokyo. It may help spread out the rush hours and possibly change the dynamic of working hours in various segments. By shifting work hours and spreading out crowded public transports, it could create a more spacious and comfortable life style for people.

FIAJ has been advocating more competition within technology vendors, more choice and lower barriers to entry for various classes of investors to participate and grow the Japanese market. Different type of investors provide market depth and help attract more participants. Similarly, bringing more competition in oligopolistic industries, such as the taxi industry, would stimulate price competition. Cheaper fares would increase the number of users, including the elderly and people who need assistance, helping raise the living standards for all. Why does it matter? Because better access will bring more people on the streets, which will create more economic activities. More economic activity means better corporate earnings, attracting more trading participant to the Japanese exchanges.

FIAJ has worked to create an environment in the financial markets that leads to more competition, in order to lower costs, by breaking the regulatory silos, permitting a single point of access for comprehensive exchanges, increase competition within technology vendors, offer more choice, etc. Our living environment also needs to evolve that way. The Tokyo Olympics represent a chance to make the actual changes. We wish for a better lifestyle after the festivities as well, which is user friendly, with more competition and easy access. Such an environment could even attract people outside of Japan and may achieve the goals of the Abe cabinet eventually.

## HKEx and LME Update

By the 8th century, metal mining and smelting were prevalent in Japan. Once the use of iron oxide was developed to improve the smelting process, the copper mining industry quickly developed through modernization of facilities, reaching 2,000 tons of copper production by the end of the 19th century. The country’s industrialisation led to a shortage of concentrate and the Japanese were trailblazers in sourcing and trading it. In 1897, trade treaties were revised to facilitate the Japanese industrial flow across oceans, enabling it to participate in what would become a world leading trading platform for base metals, the London Metal Exchange (LME).



Today, Japan remains one of the most important markets for the LME with consumption of approximately 5 per cent of the world's copper, 7 per cent of the world's aluminum and 5 per cent of LME listed brands. In addition, the LME has three Japanese ring-dealing members including Triland Metals, Mitsui Bussan Commodities Limited and Toyota Tsusho Metals Limited. "The Japanese brokers are an integral part of the LME community in Asia," said Garry Jones, Chief Executive of the LME.

Since its acquisition by HKEx in December 2012, the LME has increased its focus on Asia. Asia's importance in the base metals market has skyrocketed due in part to the rate of industrialisation in China. China has driven the consumption of the LME's core products, such as copper and zinc, and now accounts for approximately 40 per cent of global consumption. This phenomenon creates an opportunity for the LME, as the increased physical consumption creates the need for risk management.

In 2013, HKEx's Chief Executive Charles Li outlined the three objectives of HKEx's commodities strategy: grow LME's existing base metals business by lowering barriers to access from Asia; extend the commodities platform from London to Asia; and extend beyond the base metals business into other commodities. HKEx launched its Asia Commodities team to combine the expertise of the LME with the HKEx footprint in the rapidly changing commodities markets in Asia.

What does this mean for LME users in Japan? The LME's Tokyo Gala event in September will include a seminar focused on exploring these issues. Mr. Jones will attend as the keynote speaker to discuss the "Evolution of the LME" and what changes in the markets mean for the LME and its clients in Asia, particularly Japan.

## Committee Activities

### Market Development Committee      Chairman Yoshio Kuno

The Market Development Committee (MDC) plans to participate in a retail investors' show. With the cooperation of the event organizer (PanRolling), MDC plans to talk at the Investment Strategy Expo (March 15). The content of the presentation has yet to be finalized, but this will be the first attempt for MDC [and FIAJ] to reach out to Japanese retail investors.

### Technology Committee      Chairman Bruno Abrioux

During the beginning of 2014, the FIAJ Technology Committee has carried four main activities:

- 1) Study the possibility to have a small roundtable of experts to discuss how to estimate "Risk" in terms of time span when using an Automated Trading System (ATS). In parallel, the Technology Committee is also working with the Market Development Committee on the idea of offering a broader presentation of ATS to a larger audience of retail investors. Both ideas will shortly be submitted to the board.
- 2) Review the progress update on FIAJ members surveyed for their interest in having the EGUS system deployed in Japan. Feedbacks are being gathered further and inputs from FIA Asia will also be included in the study.
- 3) Start reviewing and summarizing the feedbacks received on the topic: "Test environments from exchanges and clearing houses –landscape and practices supporting higher quality deliveries". Our Technology Committee intends to issue the result of this study by the end of March, adding to it a gathering of key details of test environments in Japan under a single format.
- 4) Attend the January call held jointly with FIA Asia / FIA W. Discussions focused essentially on exchanging views and updates regarding the Hanmag Securities Co.'s ATS incident from December 2013 in Korea. Since erroneous trade cancellation rules in Korea were pointed out during the review of this case's snowball effect, our Technology Committee has decided to run a deeper analysis on the trade error cancellation policies today in place on the Japanese exchanges. The results are summarized in this newsletter's article: "To Bust, or Not to Bust, That Is the Question."

## **Commodity Study Group**      Makoto ("Mac") Sugitani, Group Leader

The Commodity Study Group (CSG) discussed potential seminars for the purpose of promoting spread transactions on TOCOM, which was proposed as a means to increase liquidity in the markets. There are several reasons why spread markets have failed to attract many broker members, so a seminar held for the management of member firms would help increase their understanding of spread transactions. Separately, another seminar targeting sales teams and prop traders is planned to cover the energy market and spread transactions in general (i.e.: Standard Combination Order "SCO") featuring presentations by professional speakers. Both seminars are scheduled to be held before TOCOM introduces inter-market [crack] spreads on March 24 (see our Future Events section for details).

In addition, the group also discussed about the exchange providing historical price spreads to support participation. Inter-commodity and calendar spreads in the global energy markets are traded by commercials, swap traders and various investors, who all contribute to increasing market liquidity. Spread orders (SCO) placed in the TOCOM markets are linked to the bids/offers in the outright markets and therefore contribute to deepening the markets. At the same meeting, CSG reaffirmed its intention to further consider trade incentive schemes (e.g: volume discount), new product launch and introducing options.

## **Exchange News**

### ***JPX***

#### **Derivatives Market Set Volume Records in 2013**

As published in the JPX trading overview, total derivatives trading volume in 2013 was 366,199,995 contracts (up 56.3% y/y), surpassing the 300 million mark for the first time.

Nikkei 225 mini futures traded a record 233,860,478 contracts (up 79.3% y/y), and Nikkei 225 Options reached a record level at 57,269,727 contracts (up 17.4% y/y). In addition, TOPIX Futures also set a new record at 22,714,121 contracts (up 49.5% y/y).

JPX will integrate the OSE derivatives market with the TSE derivatives market on March 24, 2014. The single platform offering an enriched and appealing product line should further enhance JPX's derivatives markets.

#### **JSCC Client Clearing Service for OTC Interest Rate Swap**

JSCC launched a Japanese yen denominated OTC Interest Rate Swap (IRS) Clearing Service on October 9, 2012. The IRS Clearing Service was initially targeted at dealer-to-dealer transactions and has gone on to be very successful, clearing over JPY650 trillion of IRS transactions as of February, 2014. JSCC's achievements in the OTC clearing space have involved 21 major Japanese, US and European financial institutions.

JSCC is currently in the final stage for the go-live of client clearing for IRS, which is scheduled for launch on February 24. As of February 3, JSCC has granted approvals to five Clearing Participants to launch IRS Client Clearing services.

### ***TFX***

#### **Euroyen Futures: New Market Maker & Extension of Discount Program**

TFX has newly appointed Mizuho Bank, Ltd. as a market maker as of February 3, 2014. In addition to Morgan Stanley MUFG Securities Co., Ltd, an incumbent market maker, the bank will jointly support the back-month delivery contracts between Quarter 7 and Quarter 12 by continuously quoting prices.

TFX also decided to extend the expiry date of Three-month Euroyen Futures Discount Program for another six months from April 1 to September 30, 2014. The Program offers a discount on trading fees of up to 90%.

## **New Interest Rate Futures Trading System Live**

Starting on February 3, TFX has introduced a new trading and clearing system for wholesale interest rate futures market. For over a decade, TFX relied on a packaged trading software that had been licensed by Euronext Liffe. This time, however, TFX appointed Fujitsu as the developer and completed the development of its own trading system.

The new system has a good scalability, is relatively easy to customize, and can be accessed through FIX Protocol, which is standard while being versatile. TFX designed the new system to be compact at first, considering the current slow market environment, making the five-year operational cost and the initial investment nearly half that of the previous system.

## **TOCOM**

### **Focuses on 4 Strategic Initiatives Including Development of Comprehensive Energy Market**

TOCOM plans to implement four strategic business initiatives designed to spur growth and open new opportunities in Japan's commodity market:

Firstly, TOCOM is focusing on developing new energy markets, which includes preparations for futures on LNG and electricity, that will create a comprehensive slate of energy products. Secondly, the Exchange intends to drive forward with collaborative efforts with other exchanges, and explore synergies between the commodity and domestic financial exchanges. Thirdly, TOCOM will work together with market participants, industry associations and regulators to eliminate various institutional obstacles, improve the system of taxation and optimize overly restrictive regulations on the solicitation of retail investors. Finally, TOCOM will accelerate efforts to improve its business through aggressive business expansion, further cost reductions in IT infrastructure among others and the reinforcement of its financial base. Along the operation of the Japan OTC Exchange, a joint venture established last year with Ginga Energy Japan, and the OTC clearing services to be launched by JCCH, TOCOM expects to contribute both to the development of the OTC market and revitalization of the commodity futures market.

### **Relaxes Rules to Facilitate Use of EFP and EFS**

TOCOM revised the rules for accepting Exchange of Futures for Physicals (“EFP”) and Exchange of Futures for Swaps (“EFS”) transactions in order to streamline the application procedure and improve convenience, effective on December 26, 2013. In accordance with the revision, applicants are now required to submit an Exchange-provided application form only, and the application period is widely extended. TOCOM expects the revisions of the rules to facilitate the utilization of EFP and EFS transactions.

## **OTHERS**

### **CME to Launch Options on Nikkei 225 Futures**

CME Group will launch Options on Yen-denominated Nikkei Stock Average futures, and will reference the Osaka Security Exchange's (OSE) Nikkei 225 (Yen) Futures contract in connection with these options contracts. These options contracts are listed with, and subject to, the rules and regulations of CME, and will be available for trading on CME Globex from April 13, 2014, pending CFTC review. These contracts offer a capital-efficient means to hedge risks or take advantage of price volatility in the Japanese stock market, which has experienced periods of elevated volatility due in part to the recent depreciation of the yen (USD/JPY).

### **SGX Derivatives Market Record**

In November 2013, SGX achieved a record open interest (over 4 million positions) driven by Options on the Nikkei 225 Futures. Exercise of these option contracts results in a long Nikkei 225 Index futures position, which corresponds with the option's contract month, for a call buyer or a put seller, and a short Nikkei 225 Index futures position for a put buyer and a call seller.



## **To Bust, Or Not to Bust - That Is the Question.**

The Korean case of Hanmag Securities Co. from last December is on everybody's mind. That said, let me zoom here on one interesting direct outcome of this incident: the change in trade error cancellation policy at the Korean Exchange (KRX). Until now, a trade cancellation could only be made upon request from a brokerage company and when the two respective parties to the transaction reached an agreement. Nevertheless, following last year's incident, the Financial Services Commission (Korean regulator) announced on January 17 that, before the middle of the year, "the KRX will be given direct authority to cancel orders if such transaction is deemed to pose threats to the security of trading settlement" (consult the [Plan to Improve Security of Derivatives Transactions](#)).

The clear objective of this amendment is to limit the impact of such incident in the future by giving full authority to the exchange to bust a trade if deemed relevant.

But what if this case had happened on one of our Japanese exchanges? What are the trade error cancellation rules in place today at JPX, TFX or TOCOM and how often have they been used so far?

Starting with the domestic cash market, the Tokyo Stock Exchange (TSE), now part of the Japan Exchange Group (JPX), implemented a policy called the [Rules for Cancelling Executed Transactions](#) back in September 2007, allowing securities firms to request the cancellation of erroneous trades. As an introduction to the rule, TSE reminds that "As a general rule, once a transaction has been executed it should not be cancelled" and "The rules for cancelling executed transactions will only be applied when the TSE believes that there will be extreme disruption to the market, such as when trading based on an erroneous order causes excessive difficulty in smooth settlements, etc.". Looking back at public records, the Rules for Cancelling Executed Transactions were used once in February 2009, after a three trillion yen order on a Capcom Co. convertible bond was incorrectly placed by a member.

Regarding the Osaka Securities Exchange (OSE), also part of the Japan Exchange Group (JPX), a trade bust policy has been in place for its derivatives market as well (Note that the Tdex+, current derivatives market of TSE, has a very similar policy). After the March 24 TSE/OSE derivatives trading system is merged, the same OSE rules are to apply. So far, neither TSE nor OSE had to use these rules on their respective derivatives markets.

To summarize, regardless of the JPX strategic trading system merger on cash and soon derivatives markets, both TSE and OSE have kept unchanged their respective trade cancellation policies. Finally, it is to be noted here that, for both TSE and OSE, the cancellation request can be triggered by either side: the trading member or the exchange, final decision for execution lying with the exchange obviously.

Looking now at the Tokyo Financial Exchange (TFX), article 14.2 "Invalidation of Market Derivatives Contracts"

Chapter IV of the [Trading Regulations](#) refers to the possibility to invalidate some executions “in the event of failure in the operation of the Exchange System”. This policy applies unilaterally in case of a technical glitch at TFX itself and comes as a complement to the various checks (order size, price) performed by TFX system on incoming orders. In practice, there has been no occurrence of the application of this rule to date.

As to our commodities market, TOCOM implemented an [Error Trade Policy](#) on March 1, 2011. Here again, it states that: “As a matter of principle, cancellation of executed trades should not be allowed in order to maintain an orderly market. However, executed trades resulting from erroneous orders placed by Trade Members, etc. (i.e.: Broker, Trade and Remote Trade Members) may be cancelled when the Exchange deems that such trades could significantly disrupt the market and damage the credibility of the TOCOM market.” Similarly to TSE and OSE, the Trade Member can initiate a trade bust request, which will have to be authorized by TOCOM, or the exchange can take the initiative under certain conditions. Apparently, the TOCOM Error Trade Policy has never been used since its introduction.

Now, back to our original question: what if the Hanmag Securities Co. case had happened in Japan and trade cancellation would have remained the only way to limit substantial damages? From the above, it looks like the Japanese exchanges have already taken various steps to allow the cancellation of erroneous trades leading to significant market disruption. Nonetheless, considering that Hanmag Securities Co. requested to KRX to cancel the execution related to only one order in Kospi 200 options from the 36,100 erroneous trades, with a loss amount lower than the required threshold for cancellation on that particular trade (according to press information), the next question is: would the Japanese exchanges have pulled the trigger to bust all erroneous trades from their side?

*Note: I would like to thank JPX, TOCOM and TFX for their active support while preparing this article.*

## Past Events

### FIA Japan New Year Party - January 15

FIA Japan held its New Year Shin-Nen-Kai Party on January 15, 2014 at Ark Hills Club. There were about 120 people attending the party. Mr. Endo of FSA and other VIPs were among the guests. Chairman Mitch Fulscher gave an opening speech, promising to extend FIAJ's activities and its service to members in 2014. Vice-Chairman Yasuo Mogi gave a toast, wishing a good year to all.



FIAJ members and their guests ready to open the new year!



# Future Events

## **FIA Japan Legal and Regulatory Committee Seminar February 25**

FIA Japan will hold a Legal and Regulatory Committee seminar, titled “Outside Looking In-the Territorial Reach of Regulatory Reform & the Re-Shaping of the Financial Markets”. Peter Jaeger, Committee Chairman will moderate the seminar.

Mr. Bob Burke, Head of Global OTC Clearing & FX Prime Brokerage at Bank of America Merrill Lynch in New York and Ms. Sarah Lee, Associate General Counsel at Bank of America Merrill Lynch in New York will deliver presentations for FIA Japan members and their guests on the highly topical issues of OTC clearing, which will be followed by a panel discussion with Mr. Burke, Ms. Lee and special guests: Peter Tierney, Regional Head Asia for Depository Trust & Clearing Corporation and Takeshi Hirano, Director Strategic Planning and Director OTC Derivatives Clearing Services for Japan Securities Clearing Corporation. Following the seminar, refreshments will be served with a chance for networking. This is a rare opportunity not to be missed.

Special thanks to our sponsors:



## **Boca 2014 - 39th Annual International Futures Industry Conference**

**March 11-14, Boca Raton**

Each spring the FIA hosts its annual meeting in Boca Raton, Florida where industry leaders from around the world gather to discuss current issues and exchange ideas. Public policy leaders including Senators and Congressmen, regulatory officials, and Congressional staff are an integral part of the program. Several FIA Japan directors and members will also be present.

## **15th Annual Japan International Banking & Securities System Forum 2014**

**February 27, Royal Park Hotel**

Japan International Banking & Securities System Forum has been building upon the big success of the previous events held for over 10 years, which attracts more than 400 attendees from the Japanese capital market community including more than 180 buy-side representatives.

FIA Japan directors will participate in the 12:50 panel titled “Trends of Financial Regulatory Reform and Financial Market Infrastructure ~Issues related to Clearing Houses~”, to be moderated by Peter Jaeger.

## **20th FOW Derivatives World Asia**

**2~3 April, Hong Kong**

FOW will hold its 20th FOW Derivatives World Asia in Hong Kong this year, for the first time in its history. FOW will bring the usual pan-continental content to its event, showcasing the key growth markets across the continent from Taiwan to Thailand. We will also be bringing Hong Kong and China to the fore with a day focused exclusively on these markets.

## **L&C 2014 - 36th Annual Law & Compliance Division Conference**

**May 7-9, Baltimore**

The FIA Law & Compliance Division holds a spring conference on the East Coast each year. Compliance officers, attorneys, and regulators consider issues affecting the legal and regulatory framework of the derivatives industry.

## **Inter-commodity SCO ("Crack Spread") Seminar**

**February 24, TOCOM**

Starting March 24, the Tokyo Commodity Exchange, Inc. (TOCOM) will start offering the Standard Combination Order (SCO) function for Inter-Commodity Spreads in its Oil and Chukyo-Oil Markets, which enables market participants to place spread orders between different commodities (“crack spread”). TOCOM plans to hold a seminar explaining the new functionality as well as the current SCO function on calendar spreads.

As a supporting organization, FIAJ Vice Chairman, Yasuo Mogi, will be one of the speakers at the event.





FIA-Japan was originally established in Tokyo in 1988 as a nonprofit organization by foreign and Japanese futures industry participants and later reorganized as a “General Incorporated Association” (“Ippan Shadan Hojin”). It is the only organization in Japan of its type with a membership drawn from the entire cross section of the derivatives industry. It has over 60 members representing the various corporate sectors participating in the derivatives industry in Japan. Their Mission is to encourage the growth and success of the Japan financial marketplace and its development as a regional and global financial center.

## FIA Japan Recent Activities

### Seminar Series Kick-off and Newsletter Update

In continuation of our efforts to bring more value to our members, our committees are organizing a series of seminars this year, the first of which being the FIAJ Legal & Regulatory seminar scheduled this February, where industry professionals from abroad and from Japan will discuss the implications of global regulatory reforms. A couple days later, FIAJ will have its own panel discussing clearing issues at a major financial conference in Tokyo. The Market Development Committee is planning to participate to a very large retail-oriented event in March to update and educate participants on HFT and algorithmic trading (tentative theme). The Technology Committee and Commodity Study Group are also working on implementing various workshops/roundtables on themes ranging from “how to manage intra-day risk” to “the benefits of using crack spreads in the energy market.”

All of these seminars are in line with FIAJ’s mission to help educate the marketplace. A comprehensive Event Roadmap is being drafted and will be made available soon. FIAJ is seeking sponsors to help finance and/or organize these events, so please contact us if you are interested.

The Editorial Board has reconducted its survey to seek feedback from FIAJ members and our readers on the contents and format of our newsletter. We have a number of ideas to improve the quality of our service (e.g: start a newsletter blog on our website, hire professional translators, continue to grow our contents/circulation), but we would welcome your input on the subject, so please take a few moments to complete this very short survey (to be closed at end of March): <https://jp.surveymonkey.com/s/2RH6L8T>

We have recently welcomed a new member (Ms. Chika Nakamura – ABN Amro Clearing), bringing our total to 19 professional members. Thanks to all of our sponsors, we target to minimize our loss for this fiscal year, even though we have increased our overall contents by 30% over the previous year. Please contact the Editor if you wish to participate in our activities or wish to sponsor our Newsletter.

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### FIA-J OFFICE

c/o White & Case LLP  
Marunouchi Trust Tower Main, 26th Floor  
1-8-3 Marunouchi, Chiyoda-ku, Tokyo 100-0005  
Tel/ fax +81 (0)3-6384-3325  
Website: <http://www.fiajapan.org/>

**Tony Crane**, *Administration Manager*

[crane@fiajapan.org](mailto:crane@fiajapan.org)

**Sayaka Morizono**, *Executive Secretary*

[morizono@fiajapan.org](mailto:morizono@fiajapan.org)

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\*Actual records for fiscal 2013

**Contact us : [editor@fiajapan.org](mailto:editor@fiajapan.org)**