

**TOKYO • 2020**

## Tokyo Olympics 2020 Lifts Spirits!



### Topics of the month

**FIAJ Strategic Planning**

**Government Official Comments on Comprehensive Exchange**

### Regulatory news

**METI Considers Relaxing Solicitation Rules**

**FIA Special Report:**

**CFTC Issues Concept Release on Automated Trading**

### People Interview

**Junichi Maruyama**, Head of Government Affairs, Citigroup Japan Holdings Corp

**“Discusses Abenomics and Regulatory Tsunami”**



Junichi Maruyama

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#### CHAIRMAN'S MESSAGE

### Abe Commits to Deregulation

Mitch Fulscher, Chairman, FIA Japan

In a strong showing at the recent APEC meetings in Bali, Prime Minister Abe publicly stated, "I can no longer lose time for necessary reforms". Action to

remove regulatory hurdles and overhauling heavily regulated sectors - including agriculture, electricity and medicine - are part of his message. These areas are included in his 'third arrow,' or structural reform, that we are eagerly awaiting. Abe is showing consistency in his recent public messages as he "vows to break through the rock-solid regulations". At the same time, the important TPP initiative on trade agreements is moving forward with Japan's active participation. Further, government is pledging to ease Japan's high corporate tax structure and there are proposals to provide corporate tax incentives and the formation of special economic zones to stimulate business activity. Interestingly, Abe even introduced "Womenomics" adding it to his "Abenomics" policy as another part of his growth plan for Japan. The goal of "womenomics" is to empower and boost women in the workforce recognizing the challenges of our shrinking population and the underutilized resource - Japanese women.

These messages from the top of the government are also having a positive effect on regulators. Top level regulatory study groups and presentations by senior FSA officials contain positive indications of a movement to encourage the development of the Japan financial center in Asia. FSA wants to see Japan's comprehensive exchange develop and take a leading role in Asia. METI is considering relaxing certain of their overly restrictive regulations that currently inhibit the commodity market. METI is also helping to encourage market development including paving the way for new energy products.

There are also positive developments on the economic front. Economic statistics released in September shows a jump in GDP up to 3.8% for August and an improved overall outlook for the fiscal year. For FIA Japan and our industry, all of this is good news and the government action is in the right direction.

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Adding to the good news, the International Olympic Committee selected Tokyo for the 2020 Summer Games! The public is elated. So are we. We congratulate Japan on this very significant opportunity and award.

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# “Junichi Maruyama Discusses Abenomics and Regulatory Tsunami”



**Mr. Junichi Maruyama**

Head of Government Affairs for Citigroup Japan Holdings Corp.

Mr. Junichi Maruyama is the Head of Government Affairs for Citigroup Japan Holdings Corp., a position he has held since July 2013. In this capacity, he is responsible for maintaining and developing relationships with key government and regulatory officials in Japan. Previously, he was Vice Chairman and member of the Board of Directors of Citibank Japan Ltd. since January 2011. He joined Citibank Japan Ltd. as Senior Advisor in October 2010.

Prior to joining Citi, Mr. Maruyama served in the Japanese government for more than 33 years, working in the Ministry of Finance, the Financial Services Agency and the Ministry of Foreign Affairs. In July 2006, Mr. Maruyama was appointed as Deputy Commissioner for International Affairs of the Japanese Financial Services Agency. He was a key member of the Financial Stability Board, Basel Committee on Banking Supervision, International Organization of Securities Commissions (Securities regulators forum) and other international regulatory bodies to represent the Japanese regulator.

Mr. Maruyama is an FIA-J Director since May 2013 and also sits on the Executive Committee.

**FIA-J: What is your perspective on the so-called “Abenomics” and how effective do you think the government’s initiatives will be to develop Tokyo as a major global financial center?**

The results of “Abenomics” so far have been positive and, in terms of the financial markets and the economy, have been having the desired effects. GDP figures have been showing strong economic growth and the CPI is moving into positive territory, indicating that the Japanese economy is now getting out of its deflationary trend. However, these positive developments in the Japanese economy do not automatically turn Tokyo into a major global financial center. “Tokyo as a major global financial center” is the slogan which has been put forward for some time, but so far without much success. The government needs to do a lot more for this to happen.

In the past, the government and the marketplace were not in complete agreement regarding what would be the most effective way to achieve this goal. In other words, there was no consensus regarding government actions between public and private sectors. Based on this experience, what the government should do first is to reach consensus regarding what it has to do, perhaps through more effective communications with the marketplace. Then it should promptly act to implement what has been agreed with full support from the market players. A successful result can only be achieved through joint efforts between the government and the marketplace.

*“The government needs to do a lot more”*



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*“a successful result can only be achieved through joint efforts between the government and the marketplace”*

**FIA-J: A “regulatory tsunami” is currently reshaping our industry worldwide. What are your views on this and where do you expect Japan to fit into the global marketplace? What regulatory issues still need to be tackled here in Japan to help further develop our markets?**

The current situation is that "re-regulation" waves are taking place everywhere in the world after the sub-prime crisis and Lehman-shock. This global trend towards tighter regulation is likely to continue for the foreseeable future. However, we should be mindful of the fact that in Japan, the situation is different from the U.S. and Europe. The sub-prime problem in the Japanese financial system was not as severe when compared to the U.S. and Europe. Therefore, the important thing is for Japan to keep the regulatory pendulum from swinging too much toward "re-regulating", the phenomena which we are currently seeing in the U.S. and Europe. This could even present an opportunity for Tokyo to improve its standing as a major global financial center.

Also there is potential for unnecessary cross-border regulatory ramifications, mainly originating from U.S. regulations such as the Dodd-Frank Act and the Volker rule. FIA should keep paying close attention to those developments outside Japan so that they will not adversely affect healthy innovative efforts in the Japanese market.

*“This could even present an opportunity for Tokyo to improve its standing as a major global financial center”*

**FIA-J: Citi joined FIA Japan this year. As a member of our Executive Committee, what are your thoughts on the roles our Association should be playing?**

The FIA's role is two-fold. First it should work with regulators to create a better regulatory environment to foster product innovation and enable smooth and orderly trading in the market. In order to do so, the FIA has to maintain its close contacts with regulators and obtain trust from regulators, so that they can exchange views with regulators who will take the opinions of the FIA as “true market voices”.

At the same time, the FIA should work hard using its market expertise to provide explanations or to disseminate information to the marketplace regarding any new or revised regulatory framework, so that market participants can trade or engineer new financial products knowing that their actions and trades are fully compliant with the regulatory framework.

**FIA-J: Thank you for sharing your insights with us. We look forward to your active involvement in our Association.**

### **METI Considers Relaxing Commodity Market Solicitation Rules**

In 2009, Japanese law prohibited commodity futures brokers to solicit retail customers more than once (i.e: if the customer rejected the offer once already). Since January 2011, the law prohibits sales representative to solicit customers through direct phone calls and/or visits, unless said customer expressly invited said solicitation.

METI will consider amending this solicitation rule by March 2014. Mr. Ishizaki, Director – Commerce and Consumer Affairs Policy Division, commented: “We will consider relaxing this rule after reviewing its effectiveness so far. We will also seek comments from relevant parties.” The Cabinet’s Council for Regulatory Reform also decided in June this year to “consider relaxing rules while keeping investor protection in mind.” Since the introduction of the solicitation rules, trading volumes on the Japanese commodity markets have shrunk to about 1/5th of their original level. It is also worth noting that solicitation is admissible for securities trading as well as financial derivatives.

Asked about the status of the LNG futures launch being currently considered by METI, Mr. Ishizaki said: “At present, we are thinking about [launching] a cash-settled market, without a delivery process and denominated in USD. As a country, the first step is to move forward with our preparations to establish a reliable LNG spot price benchmark.” In order to establish an LNG futures market, the Commodity Exchange Act would have to be amended to allow for the listing of “intangible commodities”. METI plans to establish a committee for this purpose, but has yet to announce a timeline.

### **CFTC Issues Concept Release on Automated Trading (FIA Special Report)**

The Commodity Futures Trading Commission issued a concept release on "risk controls and system safeguards for automated trading" in the U.S. derivatives markets. The CFTC said the concept release, which covers more than 100 pages, will serve as a "platform" for cataloguing existing industry practices, determining their efficiency and implementation to date, and evaluating the need for additional measures. "We have witnessed a fundamental shift in markets from human-based trading to highly automated electronic trading," CFTC Chairman Gary Gensler said in a statement. "This concept release is intended to stir public discussion and debate on how best to protect the functioning of markets...particularly in light of the reality that the majority of the market is using automated trading systems."

A major focus of the concept release is the prevention of market disruptions such as the Flash Crash in April 2010 that were linked to the malfunction of an automated trading system or a trading platform. The release discusses several types of risk controls that could limit the extent of such disruptions, such as a "kill switch" that could be used to immediately cancel all working orders generated by an automated trading system and prevent further order entry. "Such a kill switch could be operated by the market participant generating orders, the clearing firm guaranteeing its trades, or the trading platform on which its orders would be executed," the release notes.

Regarding high-frequency trading, the concept release describes HFT as a form of automated trading and asks for comment on a definition of HFT developed by a working group of industry experts sponsored by the CFTC's Technology Advisory Committee. The release asks whether HFT should receive "different regulatory attention" than automated trading in general, including whether a different set of risk controls is needed for systems and firms that engage in HFT.

The concept release is organized into two parts: a description of the operational characteristics of automated trading environments, including potential risks and preventative measures, and an extensive description of a wide range of risk controls, system safeguards and other protections. The release reviews existing risk management practices at exchanges, clearing firms, and trading firms and asks for comment on whether these existing practices would benefit from “additional granularity or regulatory standardization.”

### FIA Japan – Strategic Planning

Over the past 25 years, FIA Japan has become a unique organization serving the derivatives industry. Our overall mission is to encourage the growth and success of the Japan financial marketplace and its development as a regional and global financial center. Considering our recent growth and the significant changes taking place in the global financial markets, our Directors requested our Executive Committee to assess our activities and our direction as a part of a strategic planning initiative. Some of the specific issues we will consider as a part of our planning include the following:

- How to enhance FIA Japan value to our members
- Consider whether to open our own FIA Japan office
- Review relationship and enhance communication with FIA Global and FIA Asia
- Enhance interaction and communication with Government regulators and agencies

We encourage our members to contact Tony Crane ([crane@fiajapan.org](mailto:crane@fiajapan.org)), FIA Japan Administration Manager, to offer any views on these subjects.

### FIA Japan Executive Secretary

At the Summer Party, held on September 10 at the Ark Hills Club, FIA-J Chairman and Vice-Chairman held a ceremony to thank Ms. Motoko Ogawa, who will be retiring at the end of October, for her dedication and services to the Association over the past years. Ogawa-san has organized our internal administration and has been instrumental in helping the Association grow. We wish her the best in her future endeavors.



In parallel, FIA-J also welcomed Ms. Sayaka Morizono who will take over the role of Executive Secretary. We are looking forward to her active participation and input to help further improve our service to our Members

(RIGHT) FIA-J Chairman, Mitch Fulscher, presents a bouquet to retiring Executive Secretary Motoko Ogawa.  
(LEFT) Mr. Fulscher introduces Ms. Sayaka Morizono to FIA-J Members at the Summer Party.

### Finance Minister Taro Aso Comments on Comprehensive Exchange

As reported by the media, speaking at a major national conference on securities held on 9/19th, Deputy Prime Minister and Finance Minister Taro Aso made the following comments on the establishment of a comprehensive exchange that would offer trading in all asset classes, including securities as well as financial and commodity derivatives: “I think this is a major issue. We earnestly wish and hope that JPX will act as the cornerstone of this comprehensive exchange.”

In its growth strategy, the government included as a priority the creation of such a comprehensive exchange in order to improve the competitiveness of the Japanese capital markets. Following the enforcement of the revised FIEA (Financial Instruments and Exchange Act) in January 2014, financial instrument exchanges will be allowed for the first time to list commodity derivatives, moving one step closer to the creation of a comprehensive exchange. In such case, regulatory supervision would also be consolidated, in principle, under the Japanese FSA, whereas currently both METI and MAFF regulate the commodity markets.



Japan Exchange Group, established after the merger of TSE and OSE, already announced in its March 2013 Mid-Term Plan its intention to enter the commodity derivatives space.

## Committee Activities

### Market Development Committee      Chairman Yoshio Kuno

With the help of the Tech committee, MDC is currently reviewing HFT-related issues, including the August 2013 FIA Volatility Study Paper and the recent CFTC Concept Release. We are planning to tackle some of the priority issues from those reviews and share our findings with FIA-J members.

### Technology Committee      Chairman Bruno Abrioux

The recent activities of FIA-J Technology Committee have been threefold:

- 1) “Global and Japanese IT Standard / Practices” and “Recommendations to Japanese exchanges” hit the highest scores in our recent member survey identifying important areas for our focus. With the various technical glitches that happened recently across the globe impacting severely the financial community, we anticipate countermeasures on how new systems and solutions are developed, tested and approved for a safe go-live. In the first place, this naturally brings under the spotlight the resources available to the financial community for a safe development, testing and validation of their mission critical applications. With JPX already working on its next generation “arrowhead” and TOCOM preparing its next system change, our committee proposes to study the landscape of test and development environments provided by exchanges across the globe (accessibility, availability, functionality, costs) and share the relevant best practices that would support higher quality releases.
- 2) A study group has been created to evaluate the level of interest, benefit and overall feasibility of deploying the EGUS system in Japan. EGUS is a system designed by FIA that helps streamline the creation and maintenance of give-up agreements between all involved parties. It has already been successfully deployed in various countries. Further information regarding EGUS can be found under: <http://www.futuresindustry.org/egus.asp>
- 3) As part of the Market Development Committee work on the “impact of HFT”, FIA-J Technology Committee has established a bridge with FIA Washington (FIA-W) IT Division in order to accelerate and ease the exchange of ideas, information and viewpoints. On the specific HFT topic, FIA-W IT Division is currently preparing their comments to the Concept Release published on September 9th by CFTC on “Risk Controls and System Safeguards for Automated Trading Environments”. This will obviously give food for thought to our technology committee!

### Commodity Study Group      Makoto (“Mac”) Sugitani, Group Leader

The FIA J Commodity Study Group is a team specializing in commodities and intends to strive to increase market activities. It will discuss matters to improve the trading environment thanks to the input provided by trade participants, from the buy-side in particular, and will forward suggestions to the relevant committees within FIA Japan. The TSE and OSE derivatives markets merger is targeted on March 2014, while discussions continue about commodity markets that could be migrated/launched on Japan Exchange Group. TOCOM is expected to announce its decision regarding its next trading system by the end of this year, which will then unveil a direction for the commodity markets in Japan. The commodity study group will raise its concerns and make suggestions in order to recover market liquidity. The industry as a whole needs to offer business opportunities with lower costs of operations and strengthen marketing to attract a wider scope of participants. While competition with overseas exchanges is becoming

ing even fiercer, it is imperative for the exchanges to consider reducing the fees and create a unique presence in the marketplace. They must focus on end-client activities and trends, and understand potential business needs for each participant group (e.g: overseas and domestic non-member traders, proprietary member traders, etc.).

Commodity markets are important to provide price benchmarks. Therefore, it is necessary for commercial hedgers to have sufficient liquidity on nearby month contracts to participate in the markets, while retail investors trade on back-end contracts with longer times to expiry. In the short term, market liquidity and trading volume must be maintained, which could be helped by attracting new high-volume players through some incentive schemes. Business incentives, such as market maker or liquidity provider schemes, need to be offered more aggressively to domestic members, non-member firms, and overseas prop traders. Domestic retail investors, trading via voice or DMA, should be introduced to strategy trading, such as calendar spreads (SCO) or inter-market (NSCO) crack spreads. We need to focus on removing any barriers within the exchange rules or on the business side to help achieve this objective. Many other proposals will surely arise once we gather various viewpoints in the markets. In the past, many such business initiatives have faced strong opposition and have failed to be implemented. However, the commodity industry now needs to share a common understanding as to how to move forward in the same direction, otherwise we will never achieve a successful transition and may simply not survive in the global marketplace.

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### **JPX**

#### **OSE DJIA Futures Volume Has Increased Sharply**

Trading volume in OSE DJIA Futures, which started trading in 2012, has increased sharply since August 2013, due to additional online brokers handling the contract and aggressive pricing by overseas investors. OSE further enhanced its market maker program, aiming to improve convenience and increase the liquidity in the market.

#### **Trading Overview for First Half of Fiscal Year 2013**

JPX published trading overview for the first half of FY2013 (Apr-Sep). Total derivatives trading volume on JPX during this period was 200,438,009 contracts, surpassing the 200 million contract level for the first time. The trading volume for Nikkei 225 mini futures reached its highest historical level at 131,227,288 contracts (up 104.7% from last year), and TOPIX futures also reached a historical high at 12,326,577 contracts (up 59.3% from last year).

JPX will integrate OSE derivatives markets together with TSE derivatives markets in March 2014, aiming to expand the derivatives markets by consolidating the systems and extending the product line-up.

#### **JSCC and JGBCC Merger**

The merger between Japan Securities Clearing Corporation (JSCC) and Japan Government Bond Clearing Corporation (JGBCC) took effect on the 1st of October. The merger enhances clearing functions and structure, including facilitating efficient operations and systems, and therefore increasing market convenience, efficiency, and stability. As part of the merger, OTC JGB clearing has been amalgamated with JSCC's other clearing services. This combination of OTC JGBs, JGB futures and IRS, broadens JSCC's coverage of yen interest rate products.

To further improve JSCC's clearing service, for both domestic and overseas participants, JSCC will work to build on the foundation of its current robust risk management and operational infrastructure.

### **TFX**

#### **Free-of-Charge Brokerage Policy for Click 365 Brokers**

Starting on October 1, TFX has implemented a trading incentive program, on a permanent basis, in order to promote the Click 365 market. With a mutual understanding and collaboration between our broker mem-

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bers, market-makers and the Exchange, the brokers have introduced promotional measures and many of them have implemented a free-of-charge brokerage policy. TFX provides financial incentive to those brokers who participate in this new incentive program.

## **Mid-term Euroyen Futures Incentive Programs**

TFX has introduced a market-making program for the 7th through the 12th contract-month in the mid-term back-months (distant contracts) of the Euroyen Futures in order to revitalize the trading activities in this particular curve. On September 30th, Morgan Stanley MUFG Securities started as the first market-maker of the program. MS began with quotes in the 7th and 8th contract-months, and plans to expand into further distant contracts.

In addition, TFX also introduced a trading incentive program for all members who have executed a trade in said contract-months. Fee discounts of up to 90% are provided.

## **TOCOM**

### **TOCOM Foreign Customer Trades at All-time High**

TOCOM September 2013 monthly volume of customer trades (sells & buy) originating overseas accounted for 42.6% of the total trades, renewing the all-time high ratio. The volume of foreign customer trades and its percentage to the Exchange's total trades started to increase significantly after the launch of the current trading platform in May 2009. In the past three years, the ratio advanced from some 10% to 42.6%. Volume of customer trades marked a new all-time high with 2,244,433 contracts in April this year. The Exchange has implemented a number of measures to strengthen its trading platform in line with global standards. Trading volume of the night session, which overlaps with U.S. and European business hours, represents as much as 40 percent of the total daily volume.

## **OTHER**

### **CME Group named 'International Exchange of the Year for Asia'**

CME Group was named 'International Exchange of the Year for Asia' by Futures & Options World (FOW) at the 2nd FOW Awards for Asia 2013. The awards ceremony held on 26 September in Singapore recognized CME Group's excellence in the launch of products and services for the Asian market in the past year. This year's win marks the second year that the company has won this particular award category, since the inauguration of the awards in 2012.

"We are honored to receive this award from FOW," said Julien Le Noble, Managing Director, Head of Asia Pacific, CME Group. "This recognition not only reflects our client-focused approach in Asia, but is also an endorsement of the investment we have made in the region and the expansion of our products and services across different asset classes in order to meet the needs of the Asian market. We look forward to continuing to enhance and expand our offerings as more customers around Asia Pacific are accessing our markets to manage their risk."

CME has also revamped its website in Japanese: <http://www.cmegroup.com/ja/>

## Past Events

### FIA Japan “Cool-Off” Summer Party

Our annual “Cool-Off” Summer Party was conducted at the exclusive Ark Hills Club on Tuesday, September 10. The party was attended by over 100 members and friends. We enjoyed cool beer, wine and conversation with our industry friends on a comfortable late summer day.

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### SFOA / FIA “Burgenstock” Conference

The Swiss Futures and Options Association and the Futures Industry Association jointly held their very successful Forum for Derivatives Markets on September 25-27. This annual European Conference was held in Geneva, Switzerland, this year with over 300 delegates attending. A separate international regulators meeting was held concurrently during the conference and was attended by many senior regulators from European, US and Asian countries where they discussed emerging regulatory changes and issues. Also, included in many of the panel sessions during the conference, the regulatory issues arising from Dodd-Frank, EMIR, MiFID and other extraterritorial changes to the financial market structures were highlighted.

Masamichi Kono, Japan FSA Vice Commissioner for International Affairs, was one of the featured speakers. He has prominently served as the Chairman of the IOSCO Board over the past year.

### FIA-J Seminar Featuring FSA Official

FIA Japan held on October 16th the first of a series of seminars titled “Current Governance of Japan’s Financial Markets”, featuring Mr. Toshihide Endo, Deputy Director-General of the FSA, as the main speaker. About 100 FIA-J Members and their guests participated to this unique event, which was followed by a cocktail reception. We thank Bank of America Merrill Lynch for providing the venue.

During his presentation, Mr. Endo discussed the current challenges FSA is facing, how the regulator is working to move Japan out of deflation (including the establishment of a Comprehensive Exchange) and the regulatory reforms linked to OTC derivatives trading. He also emphasized that FSA has adopted a risk based regulatory oversight of the financial industry and their auditors are striving to utilize “principle based” auditing rather than a “rule based” compliance audit approach. At the reception, Mr. Endo commented that “FSA is committed to support the development of Tokyo as a regional financial center in Asia”.



FIA-J Directors with Mr. Endo of FSA (second from left)



## Future Events

### FIA Expo 2013 - November 5-7, Chicago

Expo, held each fall in Chicago, is the largest futures industry event in the world. More than 5,000 people visit the exhibit hall that showcases the latest products and services. Seminars address brokerage issues, trading systems and strategies, and operations and technology.

The Japanese futures industry will also be represented, including our exchanges - JPX, TFX and TOCOM as well as several of our FCM’s and technology members.

### [9th Annual FIA Asia Derivatives Conference - December 3-6, Singapore](#)

The FIA Asia event focuses on the derivatives industry in the Asia-Pacific region, featuring information exchange sessions as well as panel discussions with industry leaders from around the region. Five-hundred and fifty senior delegates from 22 countries and more than 150 firms attend this annual event. Executive-level and other senior managers comprise 76% of the delegate list, making FIA Asia the place to network in the Asia-Pacific region. A separate “International Regulators

Meeting” is held concurrently wherein regulators from around the region as well as CFTC meet to discuss emerging regulatory changes and issues.

### **Market Forum – November 8th, Tokyo**

The 9th Annual Market Forum event will be held at Otemachi Sankei Plaza on November 8th. It is a gathering of around 400 participants mainly coming from the local trading community. As registration has been started in September, please visit the website of the organizer in case of interest.

NPO Japan Financial Security Industry Market Forum:  
[http://www.marketforum.jp/e\\_index.html](http://www.marketforum.jp/e_index.html)

### **JCFIA Commodity Seminars, December, Tokyo & Osaka**

Japan Commodity Futures Industry Association, together with Tokyo Commodity Exchange and Osaka Dojima commodity Exchange, are to hold lectures on CX (i.e: commodity futures) market trend in Tokyo (12/4th) and Osaka (12/6th).

Speakers will include Mr. Akio Shibata, Representative

Director, Natural Resource Research Institute (former Director of Marubeni Research Institute) who will talk about the TPP impact over the food market, and other market professionals on rice, rubber and precious metals, who will introduce the latest market analysis.

Invitations will be sent from mid-November. Applications can also be made through the investor site “Minna no commodity (Commodities for All)” <http://cx.minkabu.jp/> (Japanese only). Admission is free.

### **Tokyo Hedge Funds Club, December 5th, Tokyo**

On Thursday 5th December hundreds of Japan’s hedge fund managers and investors are coming together for the Tokyo Hedge Funds Club year-end party at the Roppongi Hills Club. Hosted by Stefan Nilsson since 2005, this by invitation-only Hedge Funds Club events in Tokyo, Singapore and Hong Kong have grown into one of Asia’s largest network of hedge fund managers and investors.

For more information: [www.hedgefundclub.com](http://www.hedgefundclub.com) or [stefan.nilsson@hedgefundclub.com](mailto:stefan.nilsson@hedgefundclub.com)

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*By Duncan Symmons, TouchFire Trading  
(Artwork by Bruno Abrioux, Tech Committee Chairman)*

## Another Day Another Disaster

When I read about the trading fault at the London Metals Exchange on 25th Sept, and saw the comment that “the problem is the latest in a string of technical failures to hit the exchanges” I felt that I had to find out if my fears of an impending global market collapse were justified or not.

For the systems and controls at the exchanges, it is not generally accepted to turn the exchange off as you can an algo, so there needs to be a much greater focus on the software development and test processes covering both for functionality and for capacity.

Let's take three recent examples...

The May 18th Facebook IPO failure was initiated by a simple design flaw that allowed traders to cancel orders during the calculation of the opening price. This is fine if there are only one or two cancels, but it is a problem if it happens several times per millisecond. This problem was aggravated by the large numbers of orders associated with the Facebook IPO. Clearly better functional and capacity testing could have identified this problem.

Likewise, the failure on the OSE in March 4th 2013 was the result of a server disconnect happening at a critical point in the matching cycle, leaving the order queue locked and unable to process further orders.

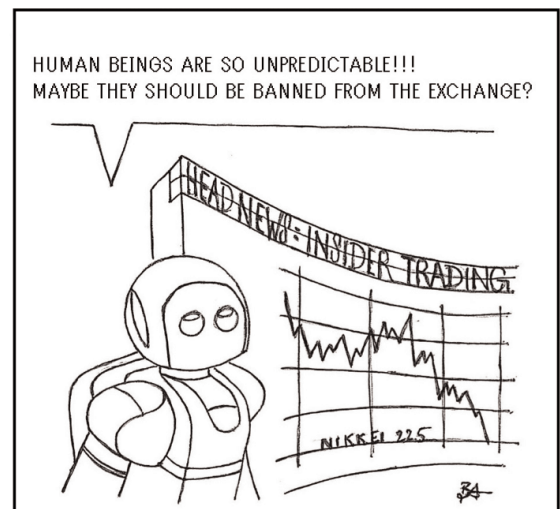
However, if we look at the Sept 4th problem on the Nasdaq Securities Information Processor (SIP), we see a unique point about the US market that contrasts significantly with the rest of the world. The current 13 stock exchanges are all linked to each other in a network, so that any exchange is required to pass on any order to the exchange with the best price at that time. This inter-connected model was dictated by the RegNMS rules enacted in 2005 to reduce the monopoly of the NYSE exchange, while ensuring that participants still got the best price. To implement this, they must also consolidate the prices from all the exchanges, and this is where the SIP comes in.

The problem with the SIP actually occurred when one exchange - the Nyse Orca - started repeatedly attempting to re-connect to the Nasdaq SIP, and the SIP ran out of memory dealing with these requests.

The complexity of the RegNMS inter-connected model contrasts with the European ‘MIFID’ rules, where the onus is put on the Brokers to manage their ‘best execution’ process. It also contrasts with the situation in Asia, where we mostly have a collection of simple independent exchanges.

We are now seeing huge attention on this issue in the US, with not only the new ‘Zero Tolerance’ policy being announced by the SEC Chair, Mary Jo White, but also the recent proposed SEC regulations on Systems Compliance and Integrity (SCI).

Overall then, looking at the “string of failures” in the exchanges rather than seeing a situation spiraling out of control globally, I see non-US markets finding and resolving periodic bugs - often arising as a result of the increased order rate of modern automated participants. Meanwhile, the US is having to take pretty extreme steps to deal with the complexity in its marketplace.. So despite not getting an explanation from the LME over their trading trading halt, I think it is probably safe to assume - for now at least - that government shutdowns are still more of a risk to the capital markets than lax programmers.



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.

## Editor's Note

### “Japan is back with an upbeat!”

With the 2020 Olympics to be held in Tokyo, and with the “Abenomics” effect still gaining traction in reforming our economy, Japan this fall has an upbeat feel not experienced in a very long time. The cash market index floats around the JPY 14,500 level and the FX rate has kept close to the JPY 100 to the USD since the beginning of the year, making for a cautious but rather optimistic mood “in and out” of the financial market arena. While Abe-san’s decision to increase consumption tax from 5% to 8% from next fiscal year, as well as the overall flat trading volumes in the commodity markets, are casting doubts on the future of our industry, the positive trends in economic indicators and the healthy volume numbers out of the financial derivatives side seem to weigh more in the balance for some market participants.

Q4 in Japan should be very interesting as both JPX and TOCOM may unfold their plans for future growth. The fact that Deputy Prime Minister Aso publically indicated that the creation of a comprehensive exchange is a top priority shows the dedication of the Japanese government to help the growth of our markets. We will keep a close eye on those developments.

FIA Japan’s mission is also to help develop the Japanese markets and our Members and various committees are committed to achieving this overall goal. Education and creating forums for discussions is an important facet of our activities. In this respect, FIA-J held a seminar on 10/16th featuring Deputy Director-General Endo of the FSA to share his insights with our Members. There are still many improvements that could be made to place Tokyo as a major financial center, and our Association, representing a unique cross-section of all industry players, is set to play a key role in these reforms.

So far, 2013 has seen a comeback of the Japanese market. 2014 may very well be the year when Japan finally returns to the front of the world scene.

*Tony Crane*



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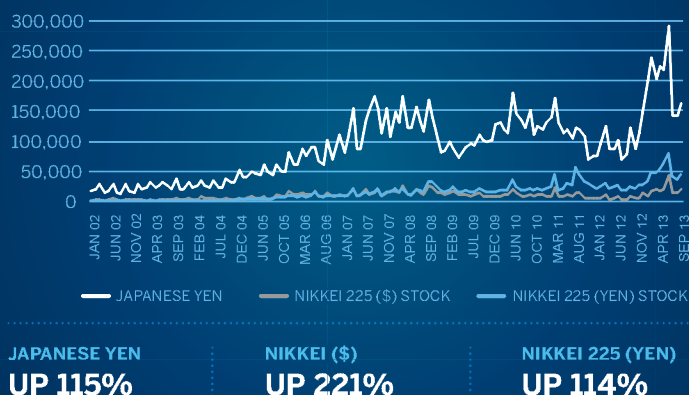
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