



Note: This document is an overall translation of the original Japanese Letter that was submitted to the regulators, and should not be taken as a word-for-word translation.

April 13, 2020

To:

Mr. Hideki Ito, Deputy Director-General, Financial Markets, Policy and Markets Bureau, Financial Services Agency

Mr. Chihiro Tobe, Director, Office of Director for Commodity Market, Commerce and Service Industry Policy Group, Ministry of Economy, Trade and Industry

Mr. Taisuke Watanabe, Director, Commodity Trade Office, Food Industry Affairs Bureau, Ministry of Agriculture, Forestry and Fisheries

Dear Sirs,

Futures Industry Association Japan (FIA Japan) welcomes the opportunity to submit the below comments and proposals with regards to the migration of the commodity markets to the Comprehensive Exchange

About Futures Industry Association Japan (General Incorporated Association)

Futures Industry Associations Japan (FIAJ) is a financial industry association whose members are composed of market and clearing participants, exchanges and other related companies in the exchange-listed derivatives markets. Further emphasized by our affiliation agreement with the Futures Industry Association (FIA), which is comprised of exchange-traded derivatives trading participants and related companies in 48 countries, FIAJ has continuously helped to promote the Japanese exchange-traded derivatives markets in and out of Japan since our establishment in 1988.

FUTURES INDUSTRY ASSOCIATION JAPAN

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Background of this Proposal

FIAJ applauds the integration of the Tokyo Commodity Exchange (TOCOM) as a subsidiary of the Japan Exchange Group (JPX) in November last year as it leads to establishing a “comprehensive exchange”. We acknowledge the wisdom and courage of the governmental regulators, exchanges and other relevant organizations, who recognized the importance of contributing to the growth of Japan’s markets through the development of Japan's derivatives markets. For 75 years, the Japanese commodity futures markets

and its participants have been kept separate by law and regulation from the financial and securities markets, negatively impacting this sector’s ability to grow and expand in the global marketplace.

We recognize that developing this comprehensive exchange market is by no means an easy task. FIAJ with its domestic and foreign market participants provides a wide range of forums for discussion to support the development of the comprehensive exchange, where the experience and knowledge can be leveraged. The recommendations set forth in this document are to introduce our concerns and suggestions in relation to the development of the comprehensive exchange derivatives market prior to its planned launch in July this year, and to also propose our roundtable meetings beginning in May 2020 to discuss market development with the several regulatory authorities, market participants, market users and the exchanges.

Significance of Comprehensive Exchange and Market Development

The comprehensive exchange concept is designed to meet the needs of various market participants in a fast-changing and evermore diverse global market, including those that need to hedge risk, investment managers, and others. In addition to managing activities in a comprehensive manner, including financial, securities and commodity derivatives market, to promote the smooth development of an international market economy, our main objective is to place the Japanese financial market on the global scene within the Asia Pacific Rim region, which would rely on the participation of global market players and related parties. Therefore, since 2006, FIAJ and its members have been focusing on making constructive achievements through proposals, recommendations and educational activities, some based on domestic and international surveys, to relevant organizations. For commodity derivatives markets in particular, since many consuming countries, including Japan, depend heavily on a stable supply of natural resources from other countries, resources which are limited in nature, the price fluctuation of international commodities has a significant impact on the national economy. Japan's commodity derivatives market should have a large influence on global markets through its price discovery function, which is an important mission. However, since Japan was unable to fully perform this function in the past, the development of a new commodity derivatives market as one of the financial instrument markets of the comprehensive exchange will help build a market infrastructure to support a smooth physical market in

Japan and the Asian region. This is an important time for the public and private sectors to share this recognition and awareness. This project also provides an opportunity to discuss a comprehensive risk management approach from a more global perspective, as economic activities become more global following the principles of market competition. In order to develop a market with a proper derivatives market function, we believe it is necessary to establish and maintain the following three factors to respond to the needs of the market in a timely manner.

1. Market convenience: Unification and simplification of regulatory environment, access to market, market and product design, cost-effectiveness for market participants, etc.
2. Market transparency: Market structure and surveillance systems necessary for the formation of proper and fair prices, including market operations and management to generate synergies amongst international futures markets, especially between cash and futures markets.
3. Market Security: Market participants and customer asset management, rules and provisions needed for smooth clearing transactions, and robust financial base of clearing organizations (CCPs).

Concerns over the current market development approach for the comprehensive exchange

In connection with the establishment of the comprehensive exchange, FIAJ, whose members consist of market participants and other related parties, wishes to express the below concerns over the current structural approach being planned to develop the market, which is to first transfer the precious metals, rubber and agricultural markets to the Osaka Exchange (OSE) in July, but to leave the electricity, crude oil and petroleum products markets to continue trading in the TOCOM entity. We hereby submit this paper at this time, considering that it is important to share our concerns on issues that may affect the future development of the market, as the transfer of products to OSE in July is approaching.

FIAJ believes that consolidating the derivatives markets in OSE is crucial to stimulating the functioning of the overall market economy and that all of the TOCOM commodity derivatives markets should be transferred to OSE. Of course, we understand that it would be difficult to realize the transfer of all TOCOM markets, including the electricity market, to the OSE by the fast-approaching time of the establishment of the comprehensive exchange in July this year, given the coordination that would be required amongst the relevant ministries/agencies and exchanges, the current infrastructure of the financial industry, and the regulatory environment for players in the spot market etc. However, before the establishment of the comprehensive exchange, we recommend that the planned future structure of the comprehensive exchange, which will include the energy markets, should be announced and be made clear to all market players. This would be a powerful step to help create a constructive market and to promote further growth.

Concern 1. Markets for commodity derivatives under multiple legal and regulatory regimes

The commodity derivatives market, which includes crude oil, provides an appropriate price setting function and a risk management function for fluctuations in market prices. It is a financial market

that facilitates the smooth distribution of physical commodities, with objectives that are different from the spot market for commodities. In order to foster the functions of the derivatives market, it is important to constantly maintain an appropriate market environment to achieve the market objectives, considering the market participant structure, customer base, the purpose of transactions and the means thereof. By leaving the energy futures markets in TOCOM and transferring the other markets to OSE, the regulatory environment for commodity derivatives and the market itself would be split in two, with OSE products being regulated under the Financial Instruments and Exchange Act (FIEA), while TOCOM products are regulated under the Commodity Derivatives Act (CDA). Anyone who wishes to trade both markets would have to comply with two sets of laws and regulations and ordinances with separate reporting requirements for market users and brokers. With regards to the regulatory environment surrounding exchange transactions and the market participants, FIAJ believes that it is essential to simplify to the extent possible and increase the convenience of the market, while maintaining the protection of investors and the market functions. Currently, commodity futures markets and other markets worldwide continue to develop quickly, and it is clear that the reason for this is the simplification of the regulatory environment, which enables faster responses to rapidly changing market needs and conditions. Knowing the historical evolution of and analysis linked to Japan's commodity derivatives markets, many domestic and overseas market participants regard the establishment of the “comprehensive exchange” as meaning a “unified regulatory environment”. Considering the significant burden to market participants of a multi-lateral set of regulations that splits JPX's overall commodity derivatives market, we believe that prolonged multiple regulatory environments will hamper the development of Japan’s derivatives market and harm the energy market.

Concern 2. JAPAN OPPORTUNITY: Positioning in Asian markets based on market synergies and the Chinese market

The establishment of the comprehensive exchange based on the integration of the exchange markets corresponds to a comprehensive organization of the financial, securities and commodity derivatives markets. In particular, the crude oil futures market, much like the precious metals

futures market, holds a very important and close relation with the financial and securities markets, as well as their respective derivatives markets. At the same time, in the investment management sector, the oil futures market is positioned as an essential diversification and alternative investment market.

Currently, the Asian crude oil futures market is largely dominated by the Chinese market in terms of trading volume, but its participants' structure is thought to be mainly composed of Chinese commercial players and private investors trading through FCMs. However, a stable market liquidity created by global market participants, whose participation is essential to set a benchmark market price relied upon by the global commodity market, has yet to be achieved. Furthermore, considering the stability of the regulatory environment in China and the relevant laws and regulations surrounding the commodity derivatives market, we believe that the risk management market function based on internationally recognized benchmark prices has not yet been fulfilled.

Given the rise in competition amongst international markets, and considering the Asian landscape, if the OSE comprehensive exchange fails to capture such important energy products,

it will reduce the interest of global participants to enter its markets, and hence reduce OSE'S ability as a global commodity derivatives market to form benchmark prices that can be relied upon globally, and disseminate information. A lost opportunity for Japan.

Concern 3. Possible market shrinking due to cost disadvantages

The precious metals market, which is the core of the TOCOM listed products, will be transferred to OSE and operations at TOCOM will then be limited to the remaining energy-only markets, with limited participation from the major and global market participants. While it is expected that TOCOM will receive financial support from the Japan Exchange Group (JPX) of companies, as an independent profit-making organization under the JPX umbrella, we believe it will be difficult for TOCOM to build a sound business environment based on its own stable earnings from its single energy market. We are concerned that the limitation in the product line and transaction benefits will not justify costs for its market participants, and thus FCMs and investors will be reluctant to participate in the market, which will result in a negative spiral leading to the market shrinking.

FIAJ established its Comprehensive Market Strategy Committee at an early stage. In order to successfully help establish the comprehensive exchange, we held seminars and conducted awareness surveys targeting participants in Japan and overseas. Through these and other means, we have held numerous

discussions among experts. The transfer of the commodity derivatives market to the established comprehensive exchange as a financial instrument market will result in different regulatory environments and operations between the spot and the derivatives markets for these commodities. However, having considered from various perspective the relation between the commodity derivatives

and spot markets, which have different regulatory environments and objectives, and taking into account the situation in other countries, we have emphasized the necessity to establish a collaborative system between the futures and the spot market regulatory bodies. The linkage of prices between cash and futures markets, as well as many market functions, is a significant challenge common to the operation of all listed derivatives markets, including financial instruments. The continued existence of diverse transaction needs across regulatory environments, such as many hedging transactions by commercial parties in the commodity derivatives market, and inter-market transactions that maintain price linkage and linkages between international markets, will lead to the activation of the derivatives market functions and the acceleration of growth in the physical market.

As mentioned earlier and as we submit this document, we wish to reaffirm that FIAJ will support the development of the comprehensive exchange into a benchmark market in the Asia Pacific Rim region by holding roundtable discussions and other events in which the public and private sectors can come together.

A handwritten signature in black ink, appearing to read 'Yasuo Mogi', is written over a horizontal line.

Yasuo Mogi

Representative Director and Chairman

Futures Industry Association Japan