FIA Japan **Newsletter**

November 2014

FUTURES INDUSTRY ASSOCIATION JAPAN

Japan Energy Market Reforms

Picture: An LNG carrier, with the characteristic round tanks, for transporting liquefied natural gas.

Topics of the month

TOCOM and OSE Agreement on Using Same Trading System

"Tokyo Global Financial Center" Initiative

FIAJ to Host Japan Financial Market Conference in May 2015

Regulatory news

METI – Launch of LNG Market

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People Interview

METI Director-General Terazawa Comments on Japanese Commodity Markets

Mr. Tatsuya Terazawa

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PRESIDENT'S MESSAGE

Japan Energy Crisis – Reform Underway

Mitch Fulscher, President - CEO, FIA Japan

The 2011 earthquake and tsunami had a devastating effect on Japanese life and property. The meltdown of the Fukushima nuclear reactors led to the government shutting down all of Japan's nuclear power facilities. Before the disaster, 30% of Japan's power was produced by nuclear plants. Replacing this source of energy has been a difficult challenge and a heavy cost to Japan's economy.

After three years, the Government has now approved a new strategic National Energy Plan. The Plan will result in liberalizing the existing energy market and broaden the sources of imported fuel to rationalize and reduce the huge costs being incurred. The Plan includes steps to review and approve the re-start of several idled reactors, if they can meet the new strict safety requirements. It is expected that two plants will be approved this autumn and possibly more by the end of the year, notwithstanding public concern and resistance against this.

Led by METI, the Government is taking action to deal with its dependency on imported oil and gas under long term contracts that are based on significantly higher prices compared to other global markets.

Focusing on liquid natural gas ("LNG") sourcing, last year Japan became the world's number one importer of LNG. The $69 billion cost last year added to its trade deficit. Several other Asian countries are also incurring extremely high costs for these imports under long term contracts, and Japan is now taking leadership to coordinate with India and discussing the formation of "buyers associations" with Singapore to deal with these high costs.

Significantly, the Government is leading the way to develop an open LNG marketplace in Japan. To enhance transparency, METI is now publishing government statistics on spot trading transactions to improve reliability of LNG pricing information. Also, they have encouraged the development of a new OTC market organized by Tocom and Ginga Energy, known as the "JOE" market. This is part of the plan to establish a price "benchmark" and to base prices on supply and demand with transparency. Tatsuya Terazawa, Director General of METI, stated in his interview for this newsletter that "the establishment of an OTC market for LNG is considered as the first step to build a comprehensive energy futures market. We are at a stage where the movement has accelerated in various fields towards the establishment of an LNG futures market." There are similar plans for deregulating the Japan electricity market and to develop a futures market for that energy product. These Government actions require amending certain laws and regulations to liberalize the markets.

The objectives of these initiatives are to help Japan work through its energy crisis and to help the economy and industry. Of course it is a major challenge to create a new market, and it is very difficult to attract players to the market and to build liquidity. Nevertheless, with METI's leadership and support, it is possible to reach this goal. At the same time, the development of this international market can further lead to the growth of Tokyo as a regional financial center.

METI Director-General Terazawa Comments on Japanese Commodity Markets

Tatsuya Terazawa
Director-General for Commerce, Distribution and Industrial Safety Policy
Ministry of Economy, Trade and Industry (METI)

Tatsuya Terazawa is METI's Director-General responsible for oversight over the commodities futures industry among other duties. He was appointed to this high level position last year. Prior to this assignment, from December 2012 to June 2013 he was Deputy Director-General, Economic and Industrial Policy Bureau and participated in the drafting of the New Growth Strategy of June 2013, the so-called third arrow of the "Abenomics." From September 2011 to December 2012, he was Executive Assistant to Prime Minister Yoshio Noda after engaging in making various economic policies. He joined METI in 1984.

He received a B.A. in Law from the University of Tokyo in 1984 and an MBA from Harvard Business School in 1990.

FIAJ：Ministry of Economy, Trade and Industry (METI) has the most important role for the Japanese industry as the overall industrial regulator. As the Director-General in charge of the "Commerce, Distribution and Industrial Safety Policy Group," what are your areas of responsibility in addition to commodity derivatives?

In addition to commodity derivatives, the key areas that the Commerce, Distribution and Industrial Safety Policy Group have jurisdiction over are: 1) Distribution and Logistics Policy; 2) Consumer Policy; 3) Industrial Safety; and 4) International Exhibitions. In relation to 1) Distribution and Logistics Policy, as many small shops in the city center area have been deserted due to the falling birth rate and the aging population, as well as the opening of large retail stores in the suburbs, we aim to improve the local economic power by encouraging investments by private sector in cooperation with the Japanese Government's effort of revitalizing local cities. Regarding 2) Consumer Policy, in the view that ensuring rational consumer behavior helps develop the industry and national economy, we are working on facilitating settlement by credit cards in parallel with ensuring safety. For 3) Industrial Safety, in order to be prepared against natural disasters, decrepitude of facilities and serious accidents, we are reviewing the regulations and standards for high-pressure gas, petrochemical complexes, city gas, and LP gas. In terms of 4) International Exhibitions, METI has taken a major role in arranging the exhibition of the Japan pavilion as a managing ministry. In cooperation with the Ministry of Agriculture, Forestry and Fisheries, we are preparing for the exhibition of the Japan pavilion at the Milan International Expo 2015.

Among the various responsibilities within the Group, I have been actively involved in commodity futures.

FIAJ：Since the Great East Japan Earthquake and its effects on nuclear facilities, Japan is faced with the urgent need to address its energy policy. What are the initiatives you are undertaking with respect to the energy markets in Japan?

The New Strategic Energy Plan approved by the Cabinet in April this year states that futures market for fuel energies, such as LNG and power, will also be developed.

If retail power is fully liberalized through the electricity system reform, the wholesale power exchange will be utilized, where transactions will be conducted based on a price reflecting the level of supply and demand.

"We are at a stage where the movement has accelerated towards the establishment of an LNG futures market"

Market price in the wholesale power exchange moves day after day. The establishment of a futures market enables new business operators to join the industry smoothly since power producers, power retailers and users will be able to hedge electricity price. This will result in the steady advance of the electricity system reform.

The value of imported LNG has increased by more than four folds over the past 10 years, as the imports of fuels for power generation have increased after the Great East Japan Earthquake. While the international price of natural gas has remained relatively stable in consequence of the shale gas revolution etc., oil prices have risen and are more volatile. The price of LNG that Japan imports is based on long-term contracts linked to the crude oil price, and therefore we are in a situation of purchasing LNG at higher prices. For this reason, we expect Japan's LNG import price to be rationalized by creating a price index that reflects the supply and demand of LNG, as well as through arbitrage transactions with international markets, including US markets where prices have been rationalized thanks to the shale gas revolution. METI started to publish government statistics on LNG spot trading prices since April this year to improve the reliability of price information. In anticipation of LNG contract renegotiations and the relaxation of destination clauses in years to come, as well as additional imports generated by new development projects, OTC trading of LNG was initiated by the Japan OTC Exchange (JOE). We are at a stage where the movement has accelerated in various fields towards the establishment of an LNG futures market.

FIAJ：The Japan OTC Exchange (JOE) was approved for opening the LNG market on September 11. How do you evaluate the current situation? What do you expect from them in the future?

The establishment of an OTC market for LNG is considered as the first step to build a comprehensive energy futures market. JOE is a joint venture of the Tokyo Commodity Exchange and Ginga Energy Japan, an oil brokerage firm based in Singapore. Currently 18 companies, including major Japanese power companies, gas companies and trading firms participate in JOE. Operation started on September 16.

"We are expecting JOE's LNG market to set the groundwork for a futures market."

We are expecting for JOE prices, which reflect the trading by actual users, to be recognized as an LNG benchmark, for OTC trading and spot trading to be activated, and for JOE's LNG market to set the groundwork for a futures market.

FIAJ：The Japanese Government has a stated goal of developing Tokyo as a leading financial center for Asia. How does the commodity futures market fit into this development? How do commodities fit into the concept of "comprehensive exchange"?

The Japan Revitalization Strategy revised in June 2014, which was approved by the Cabinet, states that the Japanese Government will create a comprehensive exchange at the first possible opportunity, and will actively endeavor to ensure that the listing of electricity and LNG futures proceeds smoothly. Efforts have been made to realize these strategies so far.

METI shares the vision to set out to create a comprehensive exchange at the first possible opportunity, while balancing with listing of electricity and LNG futures. To that end, it is important that the Tokyo Commodity Exchange (TOCOM) and Japan Exchange Group (JPX Group) cooperate. As a first step of cooperation, both exchanges agreed on September 24 to sharing a trading system and a closer relation of IT resources. As a result, cost-cutting and the increase of investors' convenience are anticipated at TOCOM, while JPX Group will have additional income by sharing the system. The decision will benefit both of them.

It is important that commodity futures be further utilized as a financial asset investment vehicle. In order

"METI shares the vision to set out to create a comprehensive exchange at the first possible opportunity"

to facilitate the entry into the commodity futures business by financial instruments business operators, we minimized the differences in procedures etc. between the Financial Instruments and Exchange Act and the Commodity Derivatives Act in July this year. In addition, METI requested the Ministry of Finance to integrate commodity derivatives with securities and the like into profit/loss calculation of financial income tax, so that investors in securities etc. can easily expand their portfolio into commodity futures. In order to facilitate hedging for commercial traders, METI requested that the Accounting Standards Committee (ASBJ) clarify the accounting standards on hedge accounting, and this is currently under review at the ASBJ.

From the viewpoint of internationalization, TOCOM started to offer a low latency network service between Chicago and Tokyo data centers on September 16, the speed of which is the world's fastest for this particular route. Today, trade from overseas accounts for about 40% of TOCOM's volume. It is expected that overseas trade will further increase through this service and the presence of the Japanese commodity futures market will be further enhanced.

FIAJ：Thank you for your comments. We are looking forward to seeing the results of all those important developments in the commodity markets.

Regulatory News

METI
Launch of LNG Market

METI approved the launch of the first LNG market in Japan on the Japan OTC Exchange (JOE), which opened for trading on September 12. The launch of this new market aims to achieve two objectives: first, to reduce the cost of securing LNG in Japan, where it represents a relatively high proportion of the energy mix in comparison to the US; and second, to create an LNG benchmark price in Asia. Up to the launch, 17 companies expressed their intention to participate in the market, most of them being major Japanese firms including electricity, gas and trading companies. JOE--a joint venture between TOCOM and Ginga Energy Japan--has been using Japan Commodity Clearing House (JCCH) for the clearing of its oil markets.

The market members currently comprise of six major electrical power companies (in Tokyo, Kansai, Chubu, Chugoku, Shikoku, and in Kyushu), the three main gas companies (Tokyo, Osaka and Toho), six major trading companies (Mitsubishi, Mitsui Bussan, Itochu, Sumitomo, Marubeni and Sojitz), as well as Idemitsu Kosan, Nissan Century Securities and Vitol (Switzerland).

The current LNG market is a spot market between commercial players, but METI and TOCOM intend to also launch a futures market to help develop the LNG market.

FSA
Rule Changes Related to Customer Solicitation for Commodity Futures (for "Comprehensive Exchanges")

On September 1, FSA enforced several rule amendments, including on solicitation and conduct, in relation to sales activities by Financial Instruments Business Operators when promoting commodity derivatives listed on a comprehensive exchange. The concept of a “Comprehensive Exchange“ was formalized recently and set a regulatory framework making it possible for the first time in Japan for a financial exchange to also list commodity derivatives, under the oversight of the FSA. Currently, no such exchange exists in Japan, even though JPX clearly stated its interest to list commodity futures. As it stands, commodity futures trading mostly occurs on TOCOM under the supervision of METI and MAFF, in accordance with the Commodity Exchange Act (CEA).

These FSA revisions relate to three main points. First, it is prohibited to solicit a customer without firstly verifying his willingness to be solicitated. Second, it is prohibited to continue to solicit a customer if he has already rejected said solicitation before. Also, when verifying a customer‘s willingness to be solicitated, if said customer is a retail customer and doesn‘t have a certain level of trading experience, it is prohibited to verify his intention either by telephone or by visiting him. Third, it is prohibited to solicit concurrent position trading (so-called “cross-trade“) or similar type of trading/position taking, and the broker must explain its own “opposite position taking“ policy, where a broker takes a position opposite of the customer‘s to lower its own risk.

“A certain level of trading experience“ as mentioned above is defined as “a customer who has an account with the broker to trade securities or derivatives.“ Even if the customer has no experience trading commodity futures, the Business Operator is allowed to solicit trading via phone or through direct visits, if said customer has an account to trade cash equities, investment trusts or bonds.

Under the current commodity markets regulated by the CEA and supervised by METI and MAFF, there is a ban on commodity trading solicitation for the products listed on Tokyo Commodity Exchange and Osaka Dojima Commodity Exchange, except for gold bullion and other products where there is a low probability of a loss greater than the original investment amount, as long as the customer doesn‘t make an inquiry himself (“ban on unrequested solicitation“). It is permitted to hold seminars, implement direct mails or advertise, as long as the objective of solicitation is clearly indicated, but brokers are not allowed to call or visit retail investors that are not their own customers. Also, even for its own customers, it is acceptable for a broker to solicit commodity futures trading to customers who already trade financial derivatives, but it is prohibited to solicit those customers who trade gold bullion and the like.

Shall a Comprehensive Exchange start offering commodity derivatives, it is possible that solicitation towards retail investors that already trade cash equities, trusts, or bonds may greatly increase.

As background information, out of a population of about 128 million, it is believed that there are roughly 12 million holding stocks, 8 million holding investment trusts, 4 million holding government bonds, 2 million holding foreign securities and about 600,000 experienced in trading derivatives (source: Japan Securities Dealers Association).

Europe and US Cross-border Regulations

On September 17, CFTC Chairman Tim Massad gave an update on the status of his talks with European regulators on the issue of clearinghouse recognition. Massad reaffirmed the CFTC's view that "dual registration" is the right approach and said that the talks are now focused on avoiding conflicts and inconsistencies within that framework.

"We are looking at whether particular regulatory objectives that we have can be met through the regulation and oversight of the home country regulator," Massad said. "We are also exploring ways to enhance cooperation in the joint supervision of dually registered clearinghouses. I am hopeful we can reach [an] agreement soon."

In parallel, European regulators are assessing whether the regulation and oversight of clearinghouses in foreign jurisdictions is "equivalent" to the regulatory regime in Europe. If equivalence is not granted for the US by December 15, European banks that are members of US clearinghouses will become subject to much higher capital requirements, which may cause some of these clearing firms to pull back from the US markets.

European regulators have indicated that the decision to grant equivalence to the US is tied to a corresponding willingness by the US to recognize European clearinghouses without requiring those clearinghouses to register with the CFTC or comply with duplicative CFTC rules.

Financial Futures Association of Japan (FFAJ) - FX Report

FFAJ commented on the growth of retail FX Margin trading as follows:

Retail Margined FX market in Japan, the so-called Mrs. Watanabe’s market, has shown a vigorous development in recent years. Since the market turmoil in 2008, the Japanese yen FX market has undergone dramatic changes. For example, the total amount of customer margin has steadily increased to reach JPY 1,200 billion in the second quarter of 2014, almost doubling from the amount deposited in the third quarter of 2008, right before the Lehman-caused financial crisis. During that same period, the number of active accounts has risen by more than 25%, from about 510,000 to over 770,000 accounts.

It is widely known among market participants that the Retail Margined FX market started in Japan in the 20th century, but it wasn't until 2005 that the market became regulated under the Financial Futures Trading Act, which was then merged with other financial regulatory laws into a single piece of legislation: the Financial Instruments and Exchange Act (FIEA). In 2009, given the market situation at that time, a new set of regulations were brought in and introduced the following: mandatory “Loss-Cut” agreement; tighter margin requirements (i.e: maximum leverage threshold set at 25 and requiring a 4% initial margin); maintenance margin through the so-called "margin calls" based on daily mark-to-market evaluation; and the segregation of clients’ funds in the form of money trusts.

In parallel with these governmental regulations, numerous self-regulatory rules have been formulated by the "FX Kanji-kai" [FX Board], the rule-making body for retail FX within the Financial Futures Association Japan (FFAJ), and these were eventually adopted by the board of FFAJ. It is believed that said regulatory framework has helped build a sound base leading to the steady growth of retail margined FX trades we've experienced in recent years.

FFAJ Research Department (headed by Mr. Tetsuo Yamazaki) compiles monthly statistics on margined FX trading, which can be accessed freely here: http://www.ffaj.or.jp/en/performance/index.html

Topics of the Month

TOCOM and OSE Agreement on Using Same Trading System

TOCOM and JPX Group announced on September 24 the signing of a letter of intent between TOCOM and OSE, a unit of JPX, for the use of a new derivatives trading system and related system support services. The system will be installed at OSE by NASDAQ OMX in 2016 and TOCOM aims to introduce it around the same time.

The new system will provide TOCOM an enhanced trading environment since the new OSE platform is well suited to handling commodity futures transactions. The arrangement will also support TOCOM market participants through reduced IT investment and technology risk. In addition, not only will the use of OSE’s new trading system reduce TOCOM’s IT investment, but it will also facilitate the entry of financial market investors into the commodity market. Cooperation between the two exchanges may also extend into areas outside IT to contribute to the further development of Japan’s derivatives market.

“Tokyo Global Financial Center” Initiative

The first meeting to promote the “Tokyo Global Financial Center” initiative was held on September 1, where members from various ministries and governmental bodies, such as BOJ, and other related industries participated and discussed about the initiatives for Tokyo to become the Global Financial Center of the Asian region.

In the opening, Tokyo Governor Masuzoe stated: “With the upcoming Tokyo Olympics and Paralympics in 2020 in our mind, we have been working for Tokyo to become the number one city in the world, where the economic sector is going to be the core of all aspects. Making Tokyo become a leading Financial Center of the world is a big project for the country. Reviving the Japanese Economy is our biggest goal for this project, so we must work together to accomplish this aim. All of us have to recognize that we are close to the cliff, so it is not time for us to talk about possible oppositions that might occur between our members.”

Four Challenges were addressed in the meeting to achieve the Tokyo Global Financial Center Plan.

“Creating an environment that facilitates the business activities of foreign companies and people in Tokyo; Creating mechanisms to attract domestic and foreign capital to anticipated growth areas in Japan; Creating mechanisms and developing new financial instruments to broaden investment of domestic financial assets from saving-centered methods to other financial instruments; and Cultivating human resources who can play an active role in the global financial center.” A working group for each challenge will be set up and will be discussing their respective agendas.

Mr. Saito, CEO of JPX, noted the following: “In order to succeed, they have identified a wide range of issues from changing financial regulations, nurturing and attracting financial professionals, to building an environment conducive to them. I welcome their suggestions because they signal their willingness toward approaching these issues together with the national government and the private sector. For example, they have suggested that the metropolitan government use the PRO-BOND Market to list foreign-denominated bonds. They do not need to look far to Europe or other overseas markets because we now have an excellent platform right here in Japan. We will look forward to working together with the Tokyo government in this area. Whether we implement measures on our own or collaborate with the Tokyo and national governments, JPX will consider the variety of options available and take initiatives to raise the global standing of the Tokyo market.”

Japan Financial Market Conference - May 12-13 2015

FIA Japan is currently organizing a major international Financial Market Conference to be held in Tokyo on May 12-13 of 2015. We plan to host this important event with the close cooperation of both FSA and METI. Similar to the FIA Japan conference that was held in July 2012, we expect to attract over 400 delegates from the Asian and global markets, as well as from Japan, and we will emphasis the interests of the "buy-side" overseas investors and traders.

The overall theme of the conference will be focused on “Japan Mission: Develop a Leading Financial Center for Asia,” which is in line with the government’s declared Economic Growth Strategy of modernizing to encourage the development of the financial market. Our conference will focus on two major aspects: Japan‘s unique position in Asia and the “new attitude” of the Japanese government and regulators.

Our Conference Task Force is currently finalizing the details of this unique event and we will announce them as they unfold through this newsletter and on the FIA Japan website.

Introducing AIMA Japan

The Alternative Investment Management Association Japan (AIMA) is a Japanese corporate association operating independently in Japan under a local license agreement. AIMA Japan was formed in 2001. It complements AIMA’s strong Asia-Pacific presence with other national groups established in Singapore, Hong Kong and Australia. The Japan group was formed in response to the strong growth in the alternative investment industry in Japan. Its corporate members include hedge funds and hedge fund managers, prime brokers, fund administrators, auditors, lawyers, placement agents and institutional investors. The objectives of AIMA Japan are to: a) Provide local representation of members located in Japan; b) Provide a unified voice for the industry in Japan; c) Increase investor education; d) Increase transparency and promote due diligence and related sound practices; e) Work closely with regulators and interested parties in order to promote the responsible use of alternate investments.

In comparing the alternative investment industry in Japan to the industry in Europe and the US, an AIMA Japan official noted: “We view that the alternative investment industry in Japan has been driven by institutional investors. In other words, Japan has not had a large group of alternative asset managers, but rather many financial institutions and pension sponsors have invested in a variety of global alternative asset classes, such as hedge funds, private equity funds and managed futures. In that sense, AIMA Japan has spent a lot of time to provide an educational program for institutional investors who wanted to invest in alternative assets.” With regards to describing some of the barriers here and what actions AIMA is taking, he commented: “Japan has a small group of start-up alternative asset managers compared to other countries considering the size of its financial market. We assume that there are a variety of reasons for that, such as high tax rates, a unique language, regulations and cultural factors. AIMA Japan wants to encourage more talented people to start hedge funds and other alternative asset management business. AIMA Japan has supported the FSA to install the new light license of Discretionary Investment Management for professional investors.”

Committee Activities

Market Development Committee

Chairman Yoshio Kuno

MDC Prepares Opinion on HFTs:
While an overheated debate about HFTs has been fading away, MDC intends to provide its opinions about HTF's value, definition, technology aspect, trading and transparency. The opinions will be collated into a short interim report to be finalized in October and to be distributed to the FIAJ board for review.

Options and Futures 101 for Retail Investors:
MDC has started developing an introductory series of contents about Options and Futures basics. The contents will initially be developed in a presentation form with a plan of being modified for a Webinar format once the technical function is made available for FIAJ.

Technology Committee

Chairman Bruno Abrioux

As FIA Japan is in the process of finalizing its plans to host the Japan Financial Market Conference in Spring 2015, the focus of our Technology Committee has naturally turned to identifying the most appropriate technology-related themes to bring on stage. Of course, we welcome here any suggestions from our members and newsletter readers. Please submit your topics of interest to crane@fiajapan.org at the latest by December 8.

In parallel, our committee has worked further on reviewing the technology risks related to the use of Automated Trading Systems (including HFT). Those technology risks have been classified under 5 categories: corrupted decision logic, erroneous static parameters/misconfiguration, inaccurate and/or delayed real-time dynamic inputs, decision and output processing issue, decision logic running beyond identified context. As a next step, the committee proposes to study and list the various means existing today to reduce if not alleviate those risks.

Other activities from the committee (EGUS/eGAINS seminar, Comprehensive Definition Framework for Market Data Redistribution) will resume upon completion of the above points.

Commodity Study Group

Group Leader Makoto ("Mac") Sugitani

At its last meeting, the Commodity Study Group (CSG) exchanged views over global commodities and talked about the traders' changing needs in the markets. The internationally-traded major commodities, energy, metals, and grains have lost momentum in the past three years. The trend is clearly observed in terms of market volume that has stayed flat or even decreased. This may be due to tightening regulatory environment, lower volatility, and worldwide deflation causing sluggish demand of physical commodities. New players are not attracted to join and adopted a wait-and-see attitude for a while. Under such environments, the markets may struggle to grow, but we see some exchanges in Asia take initiatives and continue to promote business. The local commodity industry needs to join forces and help grow the markets in a coordinated approach in order to compete with overseas exchanges.

CSG Group Leader, Mr. Sugitani, interacts with buy-side on a daily basis for business, whether commercial or non-commercial interest, and noticed that they may still come back to the market potentially and trade at a good level of liquidity. CSG continues to watch the buy-side trend in order to advise for appropriate actions, if necessary, to be taken by the industry.

Exchange News

JPX

OSE Awarded as Exchange of the Year

OSE, a JPX Group company, has received the "Best Asian Derivatives Venue of FOW Awards for Asia 2014." This Exchange of the Year 2014 - Asia award was voted in Singapore by a distinguished panel of industry experts and it recognizes excellence in market operations and market developments throughout the previous year. The judges praised in particular OSE's efforts towards the successful smooth integration of the derivatives market in March 2014, migrating the Tdex+ market onto J-GATE, as well as the broadening of the product line-up and achieving historic record volumes in spite of challenging market conditions globally.

Launch of JPX-Nikkei Index 400 Futures

OSE will be launching JPX-Nikkei Index 400 Futures on November 25 to accommodate strong investor demand. Since the launch of JPX-Nikkei Index 400, there are more than 20 new ETFs, publicly offered investment trusts, and other products tracking the index. With a market whose total NAV has already grown to nearly JPY 250 billion, demand has been rising for a futures market to facilitate more sophisticated asset management operations.

New Market Maker Scheme for Nikkei 225 Options

OSE has implemented a market maker scheme for Nikkei 225 Options on October 1, where the designated market maker will quote on Nikkei 225 Options on 19 strikes for both put and calls for the second and third contract month during regular day session. Designated market makers will be quoting continuously. This is expected to enhance market liquidity and convenience to market players.

TFX

Hosting Annual Click Festival 2014 Event

TFX is hosting an event called "Click Festival 2014 – Stock & FX: Trading Strategy Forum" at HULIC HALL in Asakusabashi on November 22. At this event, which consists of four parts, industry experts will address the present situation and future prospects in stock and FX markets through a range of seminars and panels. As Click Kabu 365 will mark its 4-year anniversary since its launch on the very day of the event, its product features and advantages will also be highlighted along with those of "Click 365."

The event will be broadcasted by Stock Voice TV (TOKYO MX) and special articles of the event will be featured on the Reuters website and Nikkei Money magazine.

Three-month Euroyen Futures Back Month Discount Program

TFX extended its Three-month Euroyen Futures Back Month discount program, which was initially introduced in September 2013, for another six months until 31 March 2015. The program is aimed to further revitalize the interest rate futures market and meet investor's trading needs in its back delivery months.

TOCOM

Japan OTC Exchange (JOE) Launched LNG Market

Japan OTC Exchange (JOE), a joint venture of TOCOM and Ginga Energy Japan, launched LNG Non-Deliverable Forward trading on September 12. The new forward market is expected to spur trading of LNG and to lead JOE LNG price to become the recognized benchmark price. Consequently, LNG should eventually be traded at prices that better reflect the supply-demand balance, as opposed to being based on crude oil prices. TOCOM will consider launching an LNG futures contract after the physical market is well established and creates hedging needs among traders.

JOE was established in November 2013 to provide an OTC platform and a brokering function for transactions of energy products and other commodities. JOE also aims at offering a highly secure trading environment with the clearing services provided by JCCH, TOCOM's clearing house subsidiary.

TOCOM Introduces ADP and Posted Settlement Transaction

As new initiatives designed to bolster the market, TOCOM introduced "Alternative Delivery Procedure" (ADP) for all petroleum products (except Crude Oil) beginning with the October 2014 contract. Commercial participants will be allowed to make and take delivery under negotiated terms or conditions that differ from Exchange standards. TOCOM aims at adding flexibility to its Oil Market and supporting those participants that trade in physical commodity.

TOCOM also adjusted rules to permit all market participants to trade at the settlement price through prior application to the Exchange. TOCOM started accepting such applications on October 6, 2014. Along with EFP/EFS and block trading, "Posted Settlement Transaction" is the third option to trade away from the market. Details are provided on the TOCOM website.

SGX

Launched New FX Futures Contracts

Singapore Exchange (SGX) added new Asian foreign exchange (FX) futures contracts on Chinese Renminbi ("RMB") (USD/CNH, CNY/USD), Japanese Yen (USD/JPY) and Thai Baht (THB/USD), to further augment its successful suite of FX offerings. The new Asian FX contracts became available for trading from October 20.

This is a timely move as Singapore overtook London in February this year to become the largest offshore RMB clearing centre outside Greater China. Total clearing amount has exceeded 10 trillion yuan (US$1.60 trillion) in the last 12 months. Average daily RMB FX trading in Singapore has almost quadrupled year-on-year to approximately US$70 billion.

Leveraging on Singapore's position as the world's third-largest foreign exchange market and a primary price discovery centre for Asian FX trading, the SGX RMB contracts will serve to address the growing needs for RMB risk management tools, such as hedging for trade financing flows and RMB deposits, risk overlay and hedging for RQFII fund managers. SGX has also forged a strategic partnership with Bank of China, which is its first Chinese settlement bank and RMB futures market maker.

Future Events

FIA Expo 2014
November 4-6, 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.

Market Forum
5 November, Tokyo
The 10th Annual Market Forum event will be held at Otemachi Sankei Plaza on November 5. It is a gathering of around 400 participants mainly coming from the local trading community. As registration has started in September, please visit the website of the organizer if you are interested.

10th Annual FIA Asia Derivatives Conference
3-5 December, 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.

Tokyo Hedge Funds Club Year-End Party
4 December, Roppongi
Asia's favourite social club for the hedge fund industry returns to Tokyo for another evening of business and pleasure for Japan’s hedge fund managers and investors. The 44th by invitation only Hedge Funds Club networking evening will take place at Roppongi Hills Club on Thursday December 4, 2014. The event's sponsors include Ogier, Maples Fund Services, Intertrust and S&P Capital IQ. For more information and sponsorship opportunities, please contact
stefan.nilsson@hedgefundsclub.com

Opinion Column

By Chika Nakamura, ABN Amro Clearing

What I Want to See at the FIA Japan Conference

FIA Japan is organizing a financial market conference in spring next year. We are inviting speakers from FSA Japan, METI, as well as the BOJ, JPX and others, on topics relevant to the growth of financial markets. Following the goals of the Abe cabinet, the overall message for the conference will be - how we can develop in Japan a leading financial center for Asia?

What are the factors we should consider to bring more market activity to Japan? Certainly more efficiency, opportunity, competition and transparency in the market are key agenda items. FIA Japan has been focusing on these factors, actively engaging the exchanges and authorities to make changes, as well as encouraging the buy-side and sell-side market participants to support progressive change.

FIA Japan is now preparing an open 'wish list' to the Exchanges and Regulators, including changes in technology and rules for more efficiency, competition and transparency. Those changes should create more opportunity for trading in the market. For instance, we requested the Exchanges to make a single point of access for all types of products to keep the cost of 'connecting' lower. Also we are requesting to update regulations to differentiate professional investors from retail investor, so that some costs can be lowered without reducing the fundamental protections offered to retail investors.

I believe the FIA Japan conference will be a great venue to discuss these and other issues and personally would like the speakers to provide much more details around 'in principal' changes that have been proposed over the past couple of years. Hearing how Japanese monetary and fiscal policy will impact the market, as well as specific details on deregulation to stimulate the growth of the financial industry would be welcomed. I am curious to find out how energy policy, which will impact our daily life and the economy, will help the commodity market and to know about the 'special economic zones' and the economic boom in Tokyo. Finally it would be interesting to hear any developments towards achieving a single exchange in Japan. I am looking forward to the Japan financial market conference next spring!

By Dr. Yoon, President of CMD Laboratory Inc.

Pondering the Risks of Algorithmic Trading

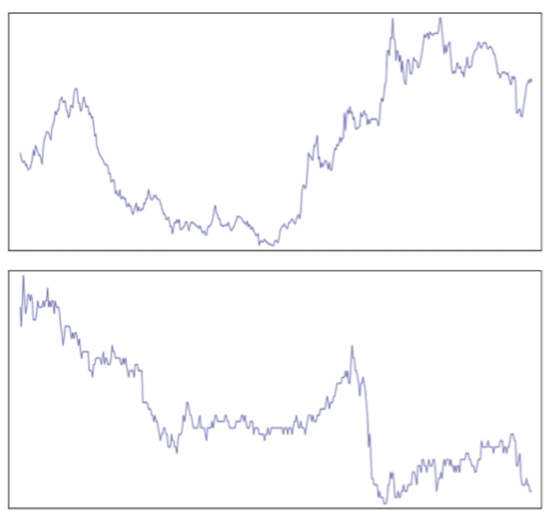
On May 6, 2010, the Dow Jones Industrial Average (Dow Index) plunged 5% in 5 minutes, from 14:40 to 14:45 New York local time, only to recover the 5% in a minute and a half starting at 14:47. In the meantime, such stocks as Accenture plc (ACN) fell from USD40 to USD0.01 (not 1 Dollar but 1 Cent!), only to come back up to the price level prior to the drop. The Flash Crash, as this market chaos has come to be called, is closely connected to the risk management of algorithm trading. In order to understand the relationship between the two, we looked into intraday movement of a market as a connecting key in this column.

The two charts below are Sony (6758) in days and intraday. While they both reflect the same data amount, the charts are left without legends in an attempt to avoid any prejudice you may have. Now, can you distinguish one from the other?

The fact is, the one above is the day chart, from January 4, 2012 to November 20, 2013, and the below one is the intraday chart, starting November 8 up to 11:30 on November 11, 2013. As difficult as it may be to distinguish the two, it can be said, through a statistical analysis, that “a day chart is actually more random than an intraday chart.”

The randomness in a day chart is generated by a strong “deviation in price fluctuation due to time dependence” right after coming in the market and right before pulling out. It is also possible that the feedback effect [selling futures to hedge against a stock crash, but actually driving stock prices further down in the process] caused by algorithm trading enhances such price deviation. Black Monday in 1987 (another sudden and sharp decline experienced in the US stock market) is typically referred to as an example of the feedback effect. Today, under the advanced IT environment, all the market participants, including retails, have access to a vast amount of information, further enhancing the feedback effect. Unfortunately, the current level of financial engineering cannot estimate accurately what impact such feedback effect may have (the situation has not changed since 1987). The reason is that the technology that could evaluate the impact on a market of your own effect (i.e: your own buy/sell activities) has yet to be developed. Risk management solutions for algorithmic trading are trying to achieve exactly that: develop a system that can evaluate one’s own impact on a market.

Chart 1: Sony (6758) day and intraday charts



In connection to algorithm trading, there is an active debate among the market participants and other observers, including regulatory bodies, whether or not flash trading, such as HFT

(High Frequency Trading), heightens price volatility and creates confusion in a market. The core of the debate lies not on the speed of the trading process but the fact that the structure of information feedback distorts the randomness of a market, randomness on which financial engineers have been basing their models so far.

Today, a number of markets are affected by algorithm trading and, therefore, IT technology has come to play much influence over the markets. In order not to have such technology increase market disorder, it is urgent to establish a software infrastructure on risk management and others regarding algorithmic trading. It is important that development of IT technology is accompanied by a new analysis approach taking into account vast amounts of data, such as intraday movements.

Past Events

FIA Japan "Cool-off" Summer Party

Our annual "Cool-off" Summer Party was conducted at the exclusive Ark Hills Club on September 17. The party was attended by around 90 members and friends. We enjoyed cool beer, wine and conversation with our industry friends on a comfortable late summer day.

Gold Sponsor: JPX JAPAN EXCHANGE GROUP

Regular Sponsor: TOCOM Tokyo Commodity Exchange

SFOA/FIA/FIA Europe "Burgenstock" Conference

The Swiss Futures and Options Associations and the Futures Industry Association jointly held their very successful forum on derivatives markets on 23-25 September. This annual European Conference is now held in Geneva, Switzerland, and with over 300 delegates in attendance, it offered an ideal forum for encouraging closer cooperation among market participants and international regulators.

LME Tokyo Event

Hong Kong Exchanges and Clearing Limited (HKEx) and the London Metal Exchange (LME), a member of the HKEx Group, hosted a seminar in Tokyo on September 10 to update participants on the LME's markets. The theme of the seminar was the metals marketplace.

The event included a speech by HKEx's Global Markets Co-head and LME Chief Executive Garry Jones on the evolution of the LME, as well as three panel discussions. There were also speeches by Tatsuya Terazawa, Director-General of the Ministry of Economy, Trade and Industry of Japan (METI), and Takamichi Hamada, Executive Vice President and Chief Operating Officer of the Tokyo Commodity Exchange (TOCOM). Key topics discussed included issues critical to the LME's markets such as financial investors in a wholesale market and influence of other markets on a regional metals market. About 190 guests representing over 70 companies attended the seminar.

Upper Left: "The Acquisition of the LME" panel discussion, moderated by HKEx Rebecca Brosnan
Upper Right: METI Director-General Tatsuya Terazawa
Below: LME CEO Garry Jones

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 approximately 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

Committee Activities

Apart from the activities of our Market Development Committee, Technology Committee and Commodity Study Group reported in this edition, our other committees are also undertaking a number of projects.

The Market Operations Committee (MOC), under the leadership of Sean Lawrence, has started working on a research project to gather various suggestions for structural improvements of the Japanese derivatives market. Issues to be considered include asset segregation rules, CCP consolidation and tax matters. The MOC welcomes participation to its discussion by any industry professionals interested in improving the Japanese market structure. For more information, please contact the FIA Japan office.

As reported by Peter Jaeger, Chairman of the Legal & Regulatory Committee, at the FIAJ September board meeting, JPX (OSE) is making inquiries to individual firms on best practices related to risk controls. Following his suggestion, the FIAJ Board agreed to prepare a unified response to the Exchange from FIA Japan member firms, which would bring a broader representation of the views of the industry.

Membership Committee (Izumi Kazuhara, Chairman): Mr. Kazuhara's committee has been active recently, with three different firms currently in the process of applying for FIA Japan Corporate Membership, one of them being from overseas. This is a very positive sign for the Association and shows that firms both in and out of Japan recognize the value of FIAJ as a unique organization, represented by a cross-section of corporation involved in our industry, ranging from exchanges to brokers to IT-related firms.

For more details on FIAJ Membership and/or our newly introduced "Sponsoring Membership", please contact the FIAJ office.

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