Public Hearing on Japan Financial Sector

And "Integrated Exchange"

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I. INTRODUCTION – JAPAN FINANCIAL MARKET: FAILURE TO GROW

- "Silo" Structure - - Basic Reason for Failure
- Historic legal / regulatory structure inhibits Japanese domestic use of markets
- Difficult to attract international users (unfriendly, costly, inefficient
- Very little interest by Government /Regulators in developing an international financial center in Japan

II. REMOVE "SILO" STRUCTURE

- Existing laws, regulations, licensing, registration rules and reporting requirements separate the financial markets into silos
- Separate regulatory agencies and separate SROs – self regulatory organizations - issuing their own reporting requirements which differ by silo
- High cost and inefficiency with different system requirements discourage users from expanding beyond the single financial sector traded – i.e. securities, commodities, financial futures. For example security brokerages do not offer commodity products due to different regulatory and legal and compliance requirements resulting in excessive cost and reporting requirements, etc.
- These requirements discourage potential international players from entering the Japan markets

III. ONE REGULATOR - A model using a single regulator over the financial industry is ideal

- It is recognized that derivatives require different expertise from cash market activities. In the US they use separate regulators over cash and derivatives (SEC and CFTC)
- If "one regulator system" is difficult to set up in the immediate short term, and if there is a separation between cash and derivatives markets, then there must be an official "Joint Regulatory Commission" to rationalize the rules for consistency and reporting

- The current structure with multiple regulators by product line will continue to obstruct growth of the markets in Japan

IV. "INTEGRATED EXCHANGE" - NOT THE SOLUTION – IT'S USELESS WITHOUT FIXING THE BASIC "SILO" PROBLEM DICUSSED ABOVE

- Government should <u>not</u> "mandate" mergers among exchanges. Such decisions are the responsibility of management and the shareholders.

- However, mergers, joint ventures and cooperation among exchanges should be encouraged and made easy by the Government and regulators

- It is clear that the current situation with multiple exchanges, many of which are considered as small, is inefficient and isn't attractive to international market players

- Financial resources for systems and safety capital and investment into research and new products is easier for larger organizations

V. CLEARINGHOUSE FUNCTION – EXTREMELY IMPORTANT FOR SAFTEY AND CREDABILITY OF MARKETPLACE

- In the commodity sector the clearinghouse is not adequate for growth of this market. Enhanced systems, management and additional capital and other resources are required. We have recommended that joint venture or merger or other affiliation with financial market clearinghouses or an international clearinghouses should be considered

- Multiple exchanges, each with their own clearinghouse, organized by product line, is not conducive to attracting users. Encouraging exchanges and their clearinghouses to cooperate on reporting requirements and other matters considering the interests of market users, is essential. The subject of "common clearinghouse" is often debated within international marketplaces. Since exchanges are private organizations owned and governed by their shareholders and directors, they must make decisions on their own based their business strategies. In any case, if they chose to have their clearinghouses come together in some way it should be made easy from a legal/regulatory aspect.

- Other cooperation to permit market users to better measure risk of positions across different clearinghouses and it effect on margining should be discussed between exchanges and their clearinghouses.

VI. TAX ISSUES OVER FINANCIAL MARKET TRANSACTIONS MUST BE ADDRESSED

- Current tax rules and ability to offset gains and losses by market users are are based on old models and not rational and impede the marketplace for both domestic and international players
- Rules must be changed based on international standards to attract business to the exchanges in Japan

VII. STRATEGY TO DEVELOP A "*TOKYO FINANCIAL CENTER"* FOR ASIA

- Develop a "vision" and strategy for Japan
- Encourage international entry into our market (including considering language barriers and onerous reporting requirements)
- Establish a high level government promotional office – *"Tokyo Financial Center Office"* to monitor and work closely with regulators and government on this important initiative.