NEWSLETTER

DERIVATIVES INDUSTRY UPDATES FOR JAPAN — MARCH 2017

PRESIDENT'S MESSAGE

Is Deregulation Coming?

Michael Ross
President - CEO
FIA Japan

President Trump is looking to follow through on the promises he made during the election. What will happen to the Dodd-Frank Wall Street Reform and the Consumer Protection Act? He signed an Executive Order on February 3, 2017 calling Dodd-Frank a "disaster." The Executive Order does not have any immediate impact, but the Treasury Secretary will consult with the Financial Stability Oversight Council and will be reporting back to the President with potential changes within 120 days. Keeping track of what is taking place on the regulatory front will be very important for all of us. In the current regulatory and political environment in Washington, it will be important for members of FIA Japan to tap into good sources of information. Our alliance with FIA will assist us greatly.

We see in the news that CFTC Chairman Massad has resigned from his post. We were fortunate to have Chairman Massad address the Japanese financial community twice through events sponsored by FIA Japan. We look forward to working with the US Embassy to providing similar venues for the next CFTC Chairman.

In this issue of the FIA Japan Newsletter, we have invited Deputy Director-General Nakajima to discuss regulatory reform in Japan with a special highlight on new laws being worked to mitigate risks around "high-speed trading." FIA Japan strives to be a vehicle that all in the industry can use to promote a strong and healthy market. We appreciate the Japanese FSA's acceptance of the invitation to be interviewed by FIA Japan to discuss new regulations and reforms. The insight we gain through this article will be beneficial to the industry. FIA Japan will continue to reach out to the various regulators involved in the derivative markets of Japan and Asia.

We introduce four new members of FIA Japan in this issue. It is good that many firms are looking to join FIA Japan. It means that we are addressing the needs of the industry. We will keep listening and acting on issues we feel will benefit the industry.

As I write this message "Haruichiban" or the first wind of Spring is blowing. I hope that the new season will bring new challenges and opportunities to all in our industry.

NEWSLETTER HIGHLIGHTS

FSA Deputy Director-General Nakajima Sheds Light on Upcoming Regulatory Reforms

Junichi Nakajima
Deputy Director-General of the Planning and Coordination Bureau of the Financial Services Agency (FSA)

Responsible for policy planning and coordination of financial markets and exchanges since 2016.

Junichi Nakajima joined the Ministry of Finance (MOF) in 1985 and assumed various positions mainly at the MOF and FSA, including as executive secretary to the Minister of State for Financial Services; Director, Insurance System Planning Office, FSA; Director-General of JETRO Vancouver; Director, Market Finance Division, MOF; Director, Debt Management Policy Division, MOF; Director, Policy Planning Division, FSA (while also Deputy Director, Financial Research Center, FSA); Director, General Coordination Division, FSA; and Deputy Director-General, Planning and Coordination Bureau, FSA (responsible for credit systems).
He graduated from the Faculty of Engineering, the University of Tokyo, in 1985 and Harvard Kennedy School in 1995.

THE AUTHORITY AND EXCHANGES HAVE DIFFICULTY GRASPING THE FULL PICTURE OF HIGH-SPEED TRADING

FIA Japan: The Working Group on Financial Markets, an advisory body to the Financial Services Agency (FSA), covered issues around high-speed trading in the Japanese financial markets. Could you give us an overview of the discussion as well as its background?

Nakajima: Advances in information technology have spurred exchanges around the world to undertake measures to minimize latencies for their markets. In Japan as well, the January 2010 launch of "arrowhead," the trading system of the Tokyo Stock Exchange (TSE), has greatly accelerated TSE's order response and information distribution speeds. In combination with the co-location service, which allows trading participants to install their servers close to the exchange's trading system, the latencies associated with transactions have been drastically reduced.

In response to these trends, the share of orders (placed, modified and cancelled) through the co-location area among all orders at the TSE in 2016 amounted to around 70%, and that of transactions executed reached 40-50%. This indicates a greater share of high-speed trading in the Japanese market.

Under these circumstances, securities companies' involvement with investors engaging in high-speed trading has been limited, and the authority and exchanges have difficulty grasping the full picture of high-speed trading and strategies used therein.

While high-speed trading is said to provide liquidity to the market, concerns have been raised with respect to its impact on market stability and efficiency, fairness between investors, price discovery functions of the markets based on medium to long-term enterprise value and system vulnerabilities. If this situation is left unattended, it could undermine efforts to create a market with sufficient depth where a variety of investors, including pension funds and individual investors, feel comfortable to participate.

With these in mind, the Working Group on Financial Markets (hereinafter the "Working Group") discussed how best to deal with issues related to high-speed trading in Japan. We welcomed representatives from FIA Japan to the meeting of the Working Group on 19 October, 2016, where they kindly shared comments from the FIA Japan Proprietary Trading Study Group. A report based on discussions at the Working Group (hereinafter the "Working Group

Report") was published in December 2016.

THE WORKING GROUP REPORT PROPOSES TO DEVELOP A REGULATORY FRAMEWORK IN WHICH HIGH-SPEED TRADERS ARE REQUIRED TO BE REGISTERED WITH THE AUTHORITY

FIA Japan: The Working Group Report suggests that it is appropriate to introduce a registration system concerning investors engaging in high-speed trading. Could you elaborate?

Nakajima: The Working Group Report proposes to develop a regulatory framework in which high-speed traders are required to be registered with the authority while giving consideration to regulatory responses taken by other jurisdictions. This framework is intended to require high-speed traders trading in the Japanese markets to meet organizational/system requirements including risk controls, and to allow the authority to identify transactions and trading strategies of such traders.

Specifically, measures to be taken under the regulatory framework are as follows:

Organizational/system requirements including risk controls

- Proper management and operation of trading systems
- Appropriate organizational arrangements and capital requirements

Notification and provision of information

- Notification of engagement in high-speed trading to the authority
- Flagging of algorithmic orders
- Provision of a description of trading strategies to the authority
- Maintaining trading records

Other measures

- Submission of business reports to the authority, etc.

When introducing the framework, its effectiveness should be ensured for traders who are based overseas and trading in the Japanese markets. Therefore, it is appropriate to prohibit securities companies from accepting orders from an unregistered high-speed trader. In addition, overseas high-speed traders should have a designated representative or agent in Japan.

IN ADDITION, OVERSEAS HIGH-SPEED TRADERS SHOULD HAVE A DESIGNATED REPRESENTATIVE OR AGENT IN JAPAN

IT IS NECESSARY TO ENSURE THAT THE SPECIFICS OF THE REQUIREMENTS AND MEASURES CAN BE FLEXIBLY ADAPTED IN LIGHT OF FUTURE DEVELOPMENTS IN THE UNITED STATES AND EUROPE

FIA Japan: Do you think there are any points that need particular attention when introducing the registration framework?

Nakajima: We are aware that high-speed trading is said to contribute to improve liquidity and tighten spreads, which is beneficial to general investors. Therefore, the regulatory framework should not uniformly exclude from the Japanese markets all high-speed trading, including the ones that contribute to the facilitation of market transactions.

In addition, it is necessary to ensure that the specifics of the above-mentioned requirements and measures can be flexibly adapted in light of future developments in the United States and Europe, while ensuring the effectiveness of the regulatory framework.

TO SUPPORT HOUSEHOLDS' STABLE ASSET BUILDING, THE GOVERNMENT IS ENGAGING IN MULTIDIMENSIONAL INITIATIVES

FIA Japan: The Working Group had lively discussions on topics other than high-speed trading. Could you tell us about them?

Nakajima: In Japan, household financial assets totaling more than 1,700 trillion yen have been accumulated. However, as more than half of those assets are held in the form of cash and deposits, the proportion of stocks, investment trusts and other investment assets is smaller than in the United States and the United Kingdom. Because of this difference, the growth of household financial assets in Japan has remained low compared with the growth of such assets in the United States and the United Kingdom, and no significant progress in households' stable asset building can be seen in Japan.

Therefore, in order to support households' stable asset building, the government is engaging in multidimensional initiatives, such as the provision of investment education and the reform of corporate governance.

In addition, it is also an important challenge to ensure that all participants including financial institutions involved in the sales of, advice on, or manufacturing of financial products among others, recognize their respective roles in the investment chain and make efforts to achieve customer-oriented business conduct. Another challenge is developing and disseminating financial products suitable for long-term, diverse and installment investments.

Moreover, with the advances in information technology, financial markets and exchanges in Japan as well as in the

United States and Europe are faced with a variety of changes. Apart from high-speed trading, new developments are found in the areas of FinTech as well as competition among trading venues following the abolition of the concentration rule (under which securities companies were required to route orders on listed securities only to these exchanges listing them, and in accordance with exchange rules).

Therefore, the Working Group has covered the following topics in addition to high-speed trading:

- Households' stable asset building and Customer-Oriented Business Conduct (fiduciary duty);
- Use of exchange-traded funds (ETFs) in households' stable asset building and the position of indexed investments;
- Competition among trading venues and alternative trading platforms; and
- Exchanges' business scopes.

A BILL TO AMEND THE FINANCIAL INSTRUMENTS AND EXCHANGE ACT WILL BE SUBMITTED TO THIS SESSION OF THE DIET

FIA Japan: Could you give us an outline of the discussions on each of those topics?

Nakajima: With regard to Customer-Oriented Business Conduct, it is desirable to create a mechanism whereby financial service providers proactively exercise their creativity and compete with each other to provide high-quality and customer-oriented financial products and services with the aim of achieving best practices and where customers select financial service providers engaging in comparatively better practices.

One effective way to do so is using a principle-based approach, rather than continuing the conventional rule-based approach. Specifically, it is appropriate that the authority formulates principles concerning customer-oriented business conduct (hereinafter the "principles"), call on financial service providers to accept the principles, and encourage them to seriously consider what is good for customers based on the principles and compete with each other to provide better financial products and services without falling into the habit of trying to do the same as others.

According to the Working Group Report, it is appropriate that the principles to be developed by the authority contain the following matters.

1. Development, Publication, etc. of the Policy Concerning Customer-Oriented Business Conduct
2. Pursuit of Customers' Best Interests
3. Appropriate Management of Conflicts of Interest
4. Clarification of Fees and Expenses
5. Easily Understandable Provision of Important Information
6. Provision of Services Suited to Each Customer
7. Frameworks for Motivating Employees Appropriately and Other Measures

Based on the above-mentioned proposal, at the FSA, we are now seeking public comments on these principles. We will work towards finalizing and publishing the principles, and take various measures to entrench customer-oriented business conduct.

Concerning the use of ETFs for household's stable asset building, the Working Group Report encourages relevant parties to work on measures to improve ETF liquidity including considering the introduction of a market-making system and to raise awareness of ETFs.

We hope that these measures will promote the use of ETFs, which enable diverse investment with a small amount of funds, for households' stable asset management.

Regarding the exchanges' business scopes, the Working Group Report suggests that an exchange should be allowed to consolidate common and/or duplicative operations such as the development of systems within the exchange group it is part of, and that the business scopes of exchange groups should be more flexible so that they can keep pace with FinTech developments. As for competition among trading venues and alternative trading platforms, the Working Group Report says it is appropriate to permit margin trading at a Proprietary Trading System (PTS) on the condition that an appropriate scheme be established to prevent excessive speculative trading.

Some of the proposals in high-speed trading and exchanges' business scopes require law amendments. Accordingly, a bill to amend the Financial Instruments and Exchange Act will be submitted to this session of the Diet.

IT IS THEREFORE AN URGENT TASK FOR US TO UPDATE OUR REGULATORY FRAMEWORK, IN ORDER TO REALIZE A FAIR AND TRANSPARENT MARKET

FIA Japan: Do you have any final comments to sum up the interview?

Nakajima: Circumstances surrounding markets and exchanges are changing rapidly in line with advances in information technology. It is therefore an urgent task for us to update our regulatory framework, paying due consideration to the proposals in the Working Group Report, in order to realize a fair and transparent market adapted to the changes.
Everyone's continued support would be greatly appreciated. Thank you.

FIA Japan: Thank you very much.

FSA Publishes 2016-2017 Strategic Directions and Priorities

In October 2016, FSA updated its business plan and issued Summary Points 2016-2017 Strategic Directions and Priorities on its website. The document indicates the goals that FSA aims to attain during the period July 2016 to June 2017, including reforming the Agency, its approaches, and supporting financial institutions in changing their business models.

Other priorities listed included encouraging FinTech innovation, industry-wide exercise to respond to cyber-attacks, and consider appropriate regulations of algorithmic trading.

Japanese Yen Risk Free Rate Report

In December 2016, the Study Group on Risk-Free Reference Rates ("Study Group"), which is comprised by potential users of risk-free reference rates such as financial institutions, published its Report on the Identification of a Japanese Yen Risk-Free Rate on the Bank of Japan website.

The Study Group has been working on the identification of a Japanese yen nearly risk-free benchmark rate since April 2015, in line with the recommendations made by the Financial Stability Board (FSB) in "Reforming Major Interest Rate Benchmarks," published in July 2014. The Study Group has identified the uncollateralized overnight call rate calculated and published by the Bank of Japan as the JPY risk-free rate. From 2017 onwards, the Study Group will continue its investigation on market practices and contract design regarding the usage of the uncollateralized overnight call rate with reference to the analysis conducted by the Study Group.

CFTC Chairman Massad Announced Resignation

On January 3, CFTC Chairman Massad said he had tendered to [the then] President Obama his resignation, effective on January 20, as reported on the CFTC website. Mr. Massad issued a statement, including some of the following comments:

"For the past two and a half years, I've had the privilege of working alongside the very talented CFTC staff, and I thank them for their dedication on behalf of the American people. I came to the CFTC with a number of priorities, and I am proud we have made significant progress in every area. We have largely finished implementing the regulatory framework for swaps, and have concentrated on the areas posing the greatest risk to the financial system."

Mr. Massad was sworn in as Chairman on June 5, 2014. He worked to build bipartisan consensus within the Commission. Over 95 percent of the more than 600 votes taken during his tenure were unanimous. Commissioner Giancarlo, who joined the CFTC in June 2014, was designated as Acting Chairman on January 20, succeeding Mr. Massad.

New Law & Regulations on Virtual Currencies in Japan

Japanese lawmakers amended the Act on Settlement of Funds in May 2016 to regulate businesses handling virtual currencies (VCs), which provide exchange services between VCs and traditional real currencies, such as Japanese yen or foreign currencies (VC Exchangers). Following the amendment to the Act, the Financial Services Agency of Japan (JFSA) has published a draft of relevant regulations in connection with the Amended Settlement Act. The draft regulations, which are currently subject to the public comment process, set forth the specific matters that relate to the registration and operation of VC Exchangers and protection of customers.

Background

In 2014, Mt. Gox, which was then the world's biggest exchange of the virtual currency, bitcoin, went bankrupt in Japan due to the misappropriation of customers' assets by the operator of Mt. Gox. Recognizing the risk of abusing VCs for money laundering or other purposes, the Financial Action Task Force, an inter-governmental body established in 1989 by the Ministers of G7 countries to develop policies and measures to combat money laundering, terrorist financing and other related threats to the integrity of the international financial system, has recommended that countries register or license natural or legal persons that provide money or value transfer services in the country, and ensure their compliance with the relevant AML/CFT measures.

In response to these background events, Japanese lawmakers enacted the Amended Settlement Act with three pillars of regulation as follows:

- Registration requirements on VC Exchange Business in Japan;
- Regulation against money laundering and terrorist financing; and
- Introduction of rules to ensure customer protection.

As delegated by the Amended Settlement Act, JFSA issued detailed regulations which will implement the framework of regulations on VC Exchangers set by the Amended Settlement Act.

Click here to view the detailed GT Law Client Alert.

Source: Client Alert from the Greenberg Traurig Tokyo Law Office, co-authored by Mr. Koichiro Ohashi, who chairs the FIA Japan Law and Compliance Committee.

TOPICS OF THE MONTH

EC Recognizes Japanese Exchanges as EMIR Equivalent Third-country Markets

In December 2016, the European Commission (EC) has adopted a decision to recognize authorized financial instruments exchanges and commodity exchanges in Japan, including OSE, TFX and TOCOM, as equivalent to regulated markets as defined by the EC (See Commission Implementing Decision 2016/2271 for details). The decision came after careful review, including regulatory supervision of these exchanges. According to TOCOM, this recognition exempts the Exchange from "particularly stringent" OTC derivatives trade regulations, including margin requirements, under the European Markets Infrastructure Regulation (EMIR).

However, as reported in the media in January, the head of the European Securities and Markets Authority (ESMA) expressed concerns over the current EU overall equivalency approach, outlining the risks that third-country entities may pose to the EU, due in part to "very limited powers regarding information collection".

Review of US Financial Regulations

As reported by FIA, on February 3, President Trump issued an executive order outlining seven core principles for financial market oversight and calling on regulators to review existing laws and regulations to determine if they promote these principles. The core principles include fostering economic growth and vibrant financial markets through more rigorous regulatory impact analysis that addresses systemic risk and market failures. The principles also include making regulation "efficient, effective and appropriately tailored" and preventing "taxpayer-funded bailouts." The order specifically directed the Treasury Secretary to report back within 120 days on the extent to which existing "laws, treaties, regulations, guidance, reporting and recordkeeping requirements" promote the seven core principles. The Treasury Secretary is directed to consult with the member agencies of the Financial Stability Oversight Council, which includes the Federal Reserve, the CFTC, the SEC and several banking agencies.

The president's order came after FIA President and CEO Walt Lukken on January 25 sent a letter to President Trump and congressional and regulatory leaders calling for a comprehensive review of all US financial reform regulation.

Membership Committee Chairman Shin Shinozuka

FIA Japan recently welcomed the following companies as new members:

Ginga Global Markets Pte Ltd , a wholly owned subsidiary of Ginga Petroleum (S) Pte Ltd which was established in 1998, is a Singapore-based brokerage firm. They provide brokerage services for over-the-counter derivatives as well as exchange-traded derivatives and specialize in energy products and commodities. They have branch offices in Tokyo and Geneva to service clients, while Ginga Shanghai services growing demands from China.

Liquid Capital Australia Pty Ltd is a part of Liquid Capital Limited, headquartered in London, with offices in Sydney, Hong Kong and Chengdu. Established in Sydney in 2004, Liquid Capital Australia is an independent market making and proprietary trading firm that focuses on the most actively traded Asia-Pacific derivatives instruments. The Company has established itself in the Asia Pacific region, participating on markets in Hong Kong, Korea, Singapore, Japan and Australia.

Susquehanna Pacific Pty Ltd is an affiliate of the Susquehanna International Group (SIG) of Companies, an international financial services group specialising in making markets for financial products including equities, derivatives, commodities, fixed interest and ETFs on exchanges worldwide. SIG was established in 1987 and has offices in the US, Dublin, Sydney, Hong Kong and China.

AT TOKYO Corporation, founded in 2000, is operating 4 data centers in Tokyo. “Mission Critical Operation” and “To Accelerate and Improve Customer’s Business” are AT TOKYO’s mottos. “Premium Rack Colocation Service” that provides environment of high connectivity and ultra-low latency is one of the optimal solution for the financial industry. There are also other data center services such as “Colocation Service” which provides larger space, “Caged Colocation Service” to provide space delimited by cages, and “Housing Service” which is available for use per rack. AT TOKYO is providing bilingual support, remote operation/management and various services according to customer’s requests and business scales.

Commodity Study Group Chairman Mac Sugitani

The Commodity Study Group worked to make a proposal to the National Futures Protection Fund to revise its fee structure. The discussion follows concerns from domestic and foreign institutional customers (non-retail customers) who do not qualify for the payment of claimable assets (up to 10 million yen per customer), or the so-called payoff compensation.
The market share of institutions at TOCOM has continued to increase, and contributes significantly to the contractual fee paid to the NFPF on every trade made on the Exchange. The NFPF is considering the proposal and is expected to soon reply to our proposal.

CSG followed up to discuss the segregation system of customers’ assets in the Japanese commodity markets. NFPF currently takes the role of monitoring FCMs for the protection of customers’ interest. It is necessary for the commodity markets to have a better system for customers’ asset protection, with improved transparency and efficiency.
On another subject, a representative of London Metal Exchange was invited to the CSG meeting held in January 2017 and we discussed about base metal markets, and shared views on the current commodity business. CSG welcomes market participants and industry professionals to join our discussions over commodity interests.

Principal Trading Group Chairman Michael Ross

In early December, FIA Japan Principal Trading Group (JPTG) – formerly called Proprietary Trading Study Group – held an in-person meeting in Singapore on the sidelines of the FIA Asia Derivatives Conference. JPTG reviewed its activities in 2016, which included: a) Response to the FSA request for public comments on financial markets and b) Presentation to the Financial System Council (FSC) where we expressed support for the introduction of prudent regulations on algorithmic trading.
The FSC Working Group on Financial Markets issued a report on December 22 summarizing its findings and recommendations for a new legislation, which could be enacted as early as mid-year 2017. One of the key points in the report was on the requirement to register HFT firms. The report reflected the recommendation made by JPTG to allow the registration to take by using a “Representative”. This means that the HFT firms will not be required to open a full-fledged office in Japan. The exact definition/scope of which has yet to be determined. Other requirements in the report included yearly reporting and possible order tagging.
As the laws are crafted and passed by the Diet, FSA will be drafting detailed regulations. FIA Japan and JPTG, in collaboration with FIA PTG and EPTA, will continue to closely monitor any development and engage with the Japanese regulator during the drafting process. We will work with the regulators to share input from the market users’ point of view and from a global perspective.

Will 2017 be the year of RegTech innovation in Japan?

While the global FinTech movement has kept blooming, offering new venues in retail banking, lending and financing, payments and transfers, insurance, wealth and asset management, there is a particular field of application that seemed on a strong uptrend in the UK and the US in 2016: RegTech.

RegTech is a blend word standing for "getting Regulation requirements addressed through Technology". More precisely, in October 2015, the Institute of International Finance (IIF) had defined RegTech as "the use of new technologies to solve regulatory and compliance requirements more effectively and efficiently" (RegTech: exploring solutions for regulatory challenges). While a large variety of established technology vendors have already been offering Governance, Risk and Compliance (GRC)-related solutions to the Financial Services Industry (FSI) for many years, what this nascent RegTech trend has in common with the overall FinTech one is that it is based on the use of new technologies brought by the recent digital revolution, allowing the conception of flexible, scalable, cost-effective, frictionless solutions. In other words, RegTech is about answering specific regulatory requirements for the FSI (and other industries) by leveraging technologies and concepts such as cloud and utilities, big data and analytics, advanced cryptography and blockchain, artificial intelligence with machine learning… Moreover, beyond technology, solution innovation is largely boosted when companies embrace modern concepts like Lean Start-up and Agile methodologies, Minimum Viable Product (MVP), open source and open API…, which start-ups are very prone to by nature.

Concrete examples of RegTech initiatives can be acknowledged in several areas with benefits to various actors of the industry. To quote a few, innovative compliance solutions were seen in real-time payment transaction monitoring, reporting and blocking to answer Anti-Money Laundering (AML) and Countering the Financing of Terrorism (CFT) requirements. Initiatives in user identity verification, with some notable attempts using blockchain technology, in order to improve the complex Know Your Customer (KYC) and Customer Due Diligence (CDD) processes also raised attention. In the same way, new machine learning technologies were applied to improve fraud detection and prevention, not only with a goal to enhance customer protection (fraudulent use of cards or online fraud) but also to directly benefit companies' operations (automated detection of fraudulent claims for insurance companies in a quicker way and at a lower cost). A number of technology companies have also focused on applying big data analytics to market surveillance. Indeed, under an increasing regulatory pressure to prevent wrong-doing in relation to trading activities, new solutions allowing to recognize prohibited trading patterns, to detect in real-time market abuse schemes or to predict possible insider trading risks, through the analysis of firms' trade data and behavioral monitoring of employees and clients, have raised strong interest among regulators, exchanges and financial institutions.

Generally speaking, according to an IIF March 2016 report (RegTech in Financial Services: Solutions for Compliance and Reporting), the following issues in compliance and regulatory reporting could benefit from the development of RegTech solutions:

・aggregating risk data (needed for capital and liquidity reporting and stress testing)
・modeling, running scenario analysis and forecasting (required for stress testing and risk management)
・monitoring of payment transactions, identifying client and legal persons and monitoring a financial institution's internal culture and behavior (as highlighted in the above examples)
・trading in financial markets (required to comply with regulations like best execution)
・identifying new regulations (with an objective to interpret implications of regulation change, to automatically adjust reporting…).

What are the key success factors supporting the development of such RegTech innovations?

First of all, there are several innovation catalysts that the RegTech shares with the broader Fintech:

① the ease of creating companies and raising funds
② the presence of an ecosystem (associations, innovation labs, incubators and accelerators) and collaboration opportu-

nities with the targeted FSI segment
③ a supportive regulatory context (regulators-run work-groups and open discussions on FinTech challenges and opportunities, availability of a regulatory sandbox, i.e. the possibility for businesses to test innovative services in a production environment where appropriate safeguards have been deployed by the regulator in order to ensure the overall financial system integrity).
④ an entrepreneurial mindset embedded by a growing pool of talents.

There are also a set of RegTech-specific factors that usually trigger the search for innovative GRC-related solutions by the FSI:
① an increasing regulatory pressure with an accelerated pace of changes impacting financial institutions associated with a greater risk exposure,
② the financial firms' overall appetite to adopt technology to manage risk and compliance
③ the access to talents with GRC expertise for the financial institutions.

How does Japan rank against these key success factors for RegTech innovation?

As far as the broad FinTech innovation catalysts are concerned, Japan ranks dramatically #89 on the "Starting a Business" category of the "Doing Business 2017 index", far below Hong Kong (#3), Singapore (#6) and the UK (#16). Nonetheless, looking more specifically at the FinTech market, while Japan usually does not show-up on the top list for FinTech hubs in terms of investment or number of start-ups, a stronger heartbeat has been felt in 2016. This can only be accelerated by the lifting of the law stipulating that banks could not acquire more than 5% of the voting rights on a group wide-basis in finance-related IT companies. This legislation change taking effect in 2017 should not only increase investments from banks into the FinTech market, but it should also help enhance the emerging ecosystem (which has been flourishing in the past few years with participants like the Japan FinTech Association, Finolab Tokyo, MUFG Innovation lab, Rakuten Fintech Fund, Monex Ventures among others), offering new opportunities for early stage innovators to partner with financial firms. Regarding the support from regulators to the FinTech market, the Japanese Financial Services Agency (J-FSA) had included FinTech in his priority list for 2016-2017 (Strategic Directions and Priorities), looking at creating a favorable environment for FinTech by reviewing the current legal framework, upgrade the payment and settlement infrastructure and facilitate the use of new financial technologies. In concrete terms, in 2016, J-FSA established a "Panel of experts on Fintech Start-ups", conducted a number of open discussions with FinTech start-ups and co-organized a FinTech Summit. The Bank of Japan also created a FinTech Center in April 2016 and launched a joint research on the use of distributed ledger with the European Central Bank. Looking at other jurisdictions who have been successful in developing their FinTech market, the introduction of a regulatory sandbox should be the necessary logical next step for Japan. Beyond a clear safe net for regulators to maintain the overall soundness of the financial system while supporting innovation, having a secure place to experiment with new services or business models in a live environment can only encourage innovators to take measured risks in launching new ventures, allowing them to quickly iterate on their ideas; this would definitely help to boost the local entrepreneurial spirit.

Concerning the specific RegTech innovation enablers, it is clear that Japanese financial institutions are under tremendous pressure to answer an increasing number of regulatory requirements. For example, at a domestic level, the AML law has just become more stringent, the Privacy Data law is to be amended shortly as well (see FIA Japan seminar report for details), and the Automated Trading Systems' regulatory framework is being worked on. In addition, Japanese financial institutions operating at a regional or global scale are being challenged by regulatory changes of all nature. To stay compliant, they have no other choice than to promptly deploy global risk and compliance processes while catering for local jurisdictions' unique requirements. Add to these regulatory requirements an increasing business risk due to the current geopolitical turbulences and cybersecurity concerns threatening institutions and their clients, and this pretty much summarizes the growing GRC headaches for these institutions. Tackling this overall regulatory and risk context definitely requires agility, calling for new solutions and services that should also aim at keeping the cost of staying compliant down. Paradoxically, according to an FIS survey taken among 107 compliance professionals during the 2016 Tokyo AML conference, 48% of domestic institutions would rather hire qualified and specialized compliance personnel than reduce manual processes and activities (30%), on-board adequate IT solutions (23%) or automate compliance reports (12%)! The cultural shift of modernizing and automating risk and compliance through technology has not yet happened for these institutions, probably coming as an impediment to RegTech initiatives. This is a clear call for further education on how technology solutions can help reduce regulatory pressure. In any case, this mindset shift may be naturally forced by the labor market situation in Japan: many companies and talent sourcing agencies already report a challenge in recruiting qualified personnel with advanced Risk and Compliance expertise…

As a conclusion, if it is clear that the domestic FinTech scene has been generally expanding throughout 2016 despite a fundamental challenge for start-ups to launch their businesses in Japan, the stage remains to be set further for RegTech. The introduction of a regulatory sandbox, some dedicated educative sessions for financial institutions to understand how technology can help answer their regulatory requirements concerns, enhancing the Fintech and RegTech ecosystems by increasing the exchange of ideas between participants and with other global FinTech hubs in order to encourage an entrepreneurial spirit are probably among the few ideas that should be explored in priority for RegTech innovation to pick up in Japan in 2017.

OPINION COLUMN

BY CHIKA NAKAMURA

Flexible Work Schedules

With a shrinking population and a resistance towards loosening immigration policies, Japan has been facing a mounting labor shortage issue. One option would be to allow more flexibility with people's work schedules. I believe this flexibility can allow our workforce as a whole to become stronger and more diverse, while enabling individuals with more convenience and ultimately help them achieve better fulfillments in their lives.

In Japan, it is still common for female workers to quit working after getting married or after the birth of a child because they are unable to work full time. The same can be said for people dealing with a major illness or some sort of chronic ailment. Due to these types of situations, some people may only be able to work in the morning, while others may only be able to work in the afternoon. I believe that this is a significant labor source that largely remains untapped.

It has also been a distinctive trend that more and more people are placing more value in their personal time and are trying to achieve better work-life balance. Working for a few days a week or promoting part time work situations could be a viable solution for these types of people. Some people may argue that this would bring chaos within companies; however, depending on how it is implemented, it could be quite beneficial for both the company and the individual.

Consider the benefits of a 4-day work week. It would certainly allow for more time with family and friend and more time to pursue personal interests. This could, in turn, reduce stress and be very beneficial to a person's mental and physical wellbeing. The health benefits would not only help the individual but it would eventually contribute to lowering social security costs. Going even further, 3-day weekends may allow people to travel more or dine out which could stimulate economic growth. It may be farfetched, but perhaps, it may even lead to an increase in birth rate.

The financial sector has proven its open-mindedness regarding the diversity in investors and the adaption of new technologies. Related to extending the night session on the OSE, technologies have allowed many financial companies to trade for longer hours without increasing the workload for the individual worker. For the company, the benefits have been obvious with increased trading volumes and revenue streams.

If we are creative with working hours and schedules, perhaps, it's possible to open the market on holidays without increasing the individual workload or the labor cost burden of the company. This could eventually bring a real change to the perception of the typical "work week" and create more choices and opportunities for the individual.

FIA Japan has focused on fairness and transparency in the market. Allowing a more flexible work schedule would not only be fair to the individual worker but also beneficial to the financial sector as a whole. We could take the lead and change the social norm regarding work schedules. While it would take some time to implement, I believe the changes in the work schedules would take us to a new era of life style.

OSE 2016 Annual Derivatives Trading Volume

Osaka Exchange – JPX Group (OSE) announced its annual trading volume for 2016. The derivatives trading volume was 337,535,243 contracts, exceeding 300 million contracts for the fourth consecutive year. Annual trading volume for the night session was 114,119,666 contracts, accounting for 33.8% of overall trading volume. Since 2014, this ratio continues to exceed 30%, therefore providing a liquid market even during night hours.

Looking at products, Nikkei 225 mini, one of OSE's most popular products, recorded the second-highest volume on record with 233,940,373 contracts, the highest being 247,159,359 contracts in 2015, and TOPIX futures reached 22,560,705 contracts, second only to the 22,714,121 contracts traded in 2013.

TFX Merging Clearing Membership of Click 365 and Click Kabu 365

Effective February 27, TFX will merge its clearing memberships of "FX Daily Futures contracts (Click 365)" and "Equity Index Daily Futures contracts (Click Kabu 365)". Following the "Principles for Financial Market Infrastructures" of CPMI-IOSCO and guidelines issued by the Japanese FSA in December 2013, TFX has been working to improve the sophistication of its risk management system as a CCP. TFX believes that combining the two memberships will advance the CCP's financial strength since the number of clearing members (for daily futures contracts) will increase as a result.

TFX to Expand Trade Bust Rules

TFX will expand its trade bust rules (Article 14.2 of Trading Regulations "Invalidation of Derivatives Market Contracts" and other related rules) effective February 27, 2017. With this amendment, TFX will be able to, at its own discretion, invalidate an erroneous trade made by its trading members when the exchange determines such trade would create risk and disruption to the market and therefore needs to be cancelled.

TFX to Abolish Side Agreement Regarding Give-up Contract for Mutual Client

Under the current TFX rules, when an end-user of TFX interest rate futures and options products wants to Give-up the contract executed through one trading member to another for clearing, TFX requires that these two trading members sign a side agreement with regard to Give-up contracts for this particular mutual client. However, effective February 27, 2017, TFX incorporates the terms and conditions stipulated in this side agreement into the exchange rules thereby abolishing the requirement for trading members to enter into such agreements as per their mutual clients. TFX hopes that this move will improve convenience for its trading members.

FUTURE EVENTS

18th Annual Japan International Banking & Securities System Forum 2017

~ Prospects for Development of Information Technology in the Financial Market

February 28, Royal Park Hotel, Tokyo

This year's Forum focuses on the following themes:
- Recent Situation of Blockchain Technology and Future Direction
- Financial Markets and AI (Artificial Intelligence)
- How to Accelerate the Implementation of "OPEN API" for Innovations
- Transforming Security Business with "New IT"
- MiFID II and Its Impact on Japanese Financial Institutions

FIA BOCA 2017: 42nd Annual International Futures Industry Conference

March 14-17, Boca Raton, Florida

More than 1,100 senior-level executives from brokerage firms, asset management firms, international exchanges and regulatory bodies will gather for FIA's most prestigious strategic conference. This year's key note speaker is David Cameron, former Prime Minister of the United Kingdom. Mr. Cameron will provide an unrivaled perspective on the future of the European Union and Britain's place in the world following Brexit; and a unique insight into the rise of populist politics at a time of profound global change.

FIA Japan Officers and members will also attend the conference. Please contact the FIA Japan office for details.

PAST EVENTS

FIA Japan New Year Party

FIA Japan held its annual New Year Party at Ark Hills Club on January 17. There were over 120 people who attended the reception. There were many other VIPs including guests from FSA, METI, and MAFF. From FIA, Mr. Bill Herder also joined the reception, sharing his insights on the benefits of the affiliation between FIA and FIA Japan that took place in October 2016.

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TOCOM Tokyo Commodity Exchange

Left: FIAJ and FIA officials closing the reception with a traditional Japanese "Sanbon-jime" (left to right: FIAJ Director Izumi Kazuhara, FIAJ President - CEO Michael Ross, FIAJ Vice-Chairman Yasuo Mogi, FIA Head of Asia-Pacific Bill Herder)
Right: participants gathered at the party are being greeted by FIAJ Chairman Junichi Maruyama

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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.

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