



FUTURES INDUSTRY ASSOCIATION JAPAN CHAPTER

July 6, 2007

The Council on Economic and Fiscal Policy
Attention: Takatoshi Ito, Ph. D.
3-1-1 Kasumigaseki, Chiyoda-ku, Tokyo, 100-8970

Gentlemen:

We have reviewed the Report of the Working Group on Financial and Capital Markets dated April 20, 2007, and recently we met with Professor Takatoshi Ito regarding the policy proposals included in that report. The Futures Industry Association – Japan Chapter (FIA-Japan) and its members represent all significant sectors of the Japan futures industry, and we are keenly interested in this most important initiative of the Council on Economic and Fiscal Policy and the Cabinet Office. We have prepared this letter to provide our comments and suggestions regarding the policy proposals.

FIA-Japan members represent all sectors of the market, and the majority of members are involved in or experienced in overseas financial markets as well as the Japan domestic market. The comments and observations included in this letter are made primarily from the perspective of users with international market experience and potential users of the Japan financial markets. Our single mission is to help to promote and support the Japan financial marketplace.

We appreciate very much the opportunity to provide our comments to The Council on Economic and Fiscal Policy on this critical matter affecting the Japan Financial Market.

Very truly yours,

A handwritten signature in black ink that reads 'MR Fulscher'.

Mitch Fulscher
Chairman, FIA-Japan



FIA – Japan Chapter

FIA-Japan is the only international organization in Japan dedicated to spreading the understanding of commodities and financial futures and options markets. We were first organized in Tokyo in 1988 as a nonprofit group by foreign and Japanese futures industry participants and we now have 60 members representing the entire cross section of the futures industry. Our organization brings together market users and intermediaries from both the commodity and financial sectors. Our membership includes FCMs, securities firms, banks, trading houses and other professional firms and technology providers to the industry, as well as the futures exchanges. See listing of members in the attached Exhibit.

We monitor and comment on Japanese legislative and regulatory developments and exchange rules affecting the futures markets and its participants. We provide a forum for discussion of industry matters and provide training, seminars and information about Japan and international market practices and regulations.

FIA-Japan is formed as a Chapter of the US organization based in Washington DC (FIA-W - see <http://www.futuresindustry.org>). FIA-W is the principal spokesman for the futures industry in the US and has a broad international membership covering the global industry. As a “Chapter”, FIA-J communicates and cooperates closely with FIA-W, however our membership and Board of Directors are separate.



I. Introduction

We have reviewed the Report of the Working Group on Financial and Capital Markets, and overall, we agree with and support the recommendations included in that Report. The global financial markets have grown dramatically over the past 20 years. Through rapid enhancements of technology and the introduction of new financial products, the leading financial centers have internationalized creating a new paradigm for the global marketplace. For various reasons, the Japan market has not kept pace during this strategically important period. Structural changes must be made with a sense of urgency if Japan is to realize its potential role...before it is too late. Our comments in this letter address some of the critical changes required.

II. Opportunity Lost

In the mid 1980s, Japan held an enviable position in terms of potentially developing its financial marketplace. With the second largest economy in the world and the largest pool of domestic savings in the world, global financial players began to focus on Japan as a potential center for their growing Asian business. Some suggested that Japan would actually replace New York and London as the leading worldwide financial center. Unfortunately, the Japan financial center did not develop in this way. Over the next 10-20 years, foreign firms setting up in Tokyo found they were unable to reasonably conduct the newly developing financial services and international business. Clearly, the domestic market in Japan was substantial, and growing, but foreign players found what they characterize as “resistance”. This market remained largely “domestic”.

New technology, and new financial products and services were being introduced in the other major financial centers but regulatory and other issues made international business difficult in Japan. As a result, foreign firms moved their headquarters for Asia out of Japan to other more “user friendly” locations – Hong Kong and Singapore where they were welcomed. It is recognized that Japan is a major global economy and requires presence and participation, but it is currently not possible to serve as the financial center for Asia business. Today, most major global financial institutions have an “Asia ex-Japan” headquarters outside of Japan. We would like to see this “lost opportunity” reversed!

III. Structural Changes Are Necessary

- Break down the “Silos”

Existing regulations have created what are called financial “silos” with limitations on



business activities, products and services for separate lines of financial services.¹ These regulations result in choking business activity and do not fit the business models of today. Users of financial products and services demand products across these silos and do not want to pay for the costs of inefficiencies of required multiple entities and restricted management. Global companies are structured to manage and control their business in a unified way with appropriate unified systems, risk management and information flow. This is not possible in Japan under the current regulatory framework. Regulatory structures causing these silos that must be addressed are:

- Firewalls
- Multiple legal entity requirements
- Licensing / registration
- Multiple Regulators control over “silos”

➤ Regulatory and Legal aspects are not “user-friendly”

Foreign firms find inadequate transparency of regulatory and legal requirements. Better clarity and predictability for market players is needed. So-called, “administrative guidance” still exists in the financial sector resulting in business that is difficult and costly.

➤ Investment Fund Activities

Managed funds, including hedge funds and other alternative investment vehicles, are growing rapidly in the capital markets. This important sector is by-passing Tokyo due to Japan’s tax uncertainties and other regulatory hurdles. Other financial centers in Asia are promoting this industry which is an integral part of the financial environment. Action to promote this business in Japan is a key part of forming the Tokyo financial center.

➤ Modernize the Exchanges

Exchanges need to further modernize and adopt global standards for structure, trade rules, cutting–edge trading engine technology and speed and system reliability, leading to less expensive transaction costs. Infrastructures to support remote memberships to various exchanges in Japan (“open access”) are essential to international business growth. Development of new products and encouragement of foreign access to the markets will result in growing liquidity and expanded activity. Exchanges should be more “accessible” with staff that speak English and staff familiar with foreign

¹ The term “financial services” includes commodity industry activities even though Japan currently restricts these activities to a separate “silo”.



exchanges' structures, products, type of participants, etc. These requirements relate to the largest exchange, as well as to the commodity exchanges.

IV. Aggressive Action is Critical

Aggressive action is required now. Significant economic developments in China and India are well underway. Each is developing its own financial market attracting international interest and these markets are expected to eclipse several Japanese markets in the future. Already the advanced global exchanges in the U.S. and Europe offer expanding products with electronic international access bypassing Japan's marketplace. Meanwhile, international firms already established their headquarters in the financial centers in Hong Kong and Singapore. If Japan is to take a position as a global market, it must take strong action immediately to overcome this situation.

- Create a Competitive Environment

A fundamental principle that should be focused on is the creation of a **Competitive Environment**. The financial sectors need to be able to freely compete and develop products and not be artificially restricted. In order to create the international market, foreign firms need to be encouraged to enter the marketplace and compete. True and free competition will result in improved productivity and innovation of product and services.

- Promote "Economically Competitive" Marketplace

Japan needs to incentivize financial business and presence. Consideration should be given for providing tax concessions or government help not only for the end users but for other relevant actors willing to invest in Japan, whether foreign or domestic.

- Revise law and regulations

Revising certain financial and commodity law and regulation is a prerequisite. Existing firewalls and restrictions of activities now in place should be revised using proven global standards. The important goals of monitoring and controlling "conflicts of interests" can be achieved and actually improved through such standards.

- Improve transparency and communication

Improving open communication between regulators and the market is required. Better clarity of rules and regulatory transparency should be a goal. Market practices in other countries should be considered. Greater use of "no-action" letters and more open



publication of regulatory matters and decisions as well as written interpretation of law and regulation needs to be a standard practice.

In order to encourage foreign access and use of the Japan market, language issues must be addressed. It is a reality that the global language of finance is English. However, the globalization of language has not been put into place in this industry in Japan. Very prompt English translation of law, regulations, exchange rules and other related industry materials is essential. Increasing the number of people fluent in English in regulatory departments interfacing with foreigners is necessary.

➤ Change of “attitude”

In order to attract foreign business to the Japan international marketplace, it must first be understood that there is an impression among management of overseas firms that foreigners in business are “tolerated” but not really “welcome”. Whether this impression is fair or correct is arguable, but not the point. Action should be taken to address this matter. Clearly the issue of transparency and communication noted above is part of the problem. There are, however, fundamental attitudes and stances among some individuals in regulatory positions and at certain exchanges that create this impression. Potential foreign users of Japan markets have meetings with certain regulators and exchanges and leave with the conclusion that either they are not welcome or that Japan is just too difficult to do business here. One step to address this issue follows below.

➤ Establish **Tokyo Financial Center Office**

In order to promote and to follow through on improvements to the Japan financial market, we believe it is necessary to establish a high level promotional office - - “**Tokyo Financial Center Office**”. The purpose for this office would be to work to create a truly international financial center in Tokyo. Although its role would be primarily promotional, it needs to be in close communication with government regulators and leaders with the clear mandate to attract business and to facilitate the international financial center. To be successful, this office must have the full support of the Government. A model for such an office can be seen in Singapore where an office - “Financial Centre Development Department” - is an integral part of the Monetary Authority of Singapore (MAS)² and works directly to promote bringing financial business to Singapore and to

² See http://www.mas.gov.sg/about_us/Departments_in_MAS.html



assure an attractive business environment for overseas firms. The effectiveness of this office is attested to by the many foreign firms that have made their decisions to establish their Asia headquarters in Singapore.

There are many suggestions made in this letter and in other reports to the Cabinet Office on how to improve the Japan financial market. In order to achieve the objectives and to provide follow-through on changes and promotion of this initiative over the long term, a standing office such as this should be established.

V. Japanese Exchanges

➤ Consolidation of Exchanges

The press and several commentators have suggested that the various exchanges in Japan should be consolidated into a holding company to be formed by the Tokyo Stock Exchange. We believe that exchanges should be *permitted* to consolidate or to otherwise expand their trading products overcoming the current silos created by existing regulation. However, we do not believe that any exchange should be *required to combine or forced* into a single exchange. Indeed, it is most important to have a competitive environment among exchanges and trading platforms and this should be encouraged. Looking at the markets in the US and Europe we find that individual competing exchanges produce innovation and efficiency both domestically and globally. As a general principle, the introduction of futures and options contracts for exchange trading should not be restricted. Financial exchanges should be permitted to introduce commodity products, and commodity exchanges should be permitted to introduce financial products.

➤ Japanese Exchanges in the Global Market

The internationalization and expansion of the Japan exchanges to attract overseas business requires changes to its structure as well as its infrastructure. In order to become a global marketplace an exchange will require significant capital investment in technology. It is clear that users require exchange trading platforms that are fast, efficient and fair. Demand for ever advancing technology will continuously require increasing investments by the exchanges. Therefore, from a business point of view, to be successful and to effectively compete domestically, as well as internationally, users of the markets would encourage exchanges to explore inter-exchange cooperation and to develop technologies that would lower the cost of entry and operation.

It is also essential to have substantial capital supporting the clearing and settlement



system (i.e. clearinghouse). Further development and improvement of the clearing systems and exploring more efficient clearing models are most desirable from the point of view of users. Global market players always consider clearinghouse “counter-party risk”, and as they determine, or limit, their use of a market, they will assess the adequacy of capital underlying the clearing system. This area should be carefully considered by exchanges in developing the Tokyo market.

VI. A sense of Urgency - Critical Priority Action Steps

It is clear that there is a multitude of action steps required if Japan is to advance their financial market and for it to become a global financial center. These actions and changes will require much time and effort and cooperation. But this will not happen unless there is a sense of urgency with “break through policies” established. Such policies must be based on a vision that is clearly stated and accepted. To achieve the vision, a firm strategy must be put into place. Follow-through will be essential to make things happen over the long term. But moving strongly and clearly and quickly will determine whether or not this initiative will be successful.

In order to consider the priorities of the many recommendations, we have listed what we believe to be the top priority action steps for your consideration:

- Develop a clear Strategy for the Tokyo Financial Market
 - Develop a “Vision” and comprehensive policies
 - Clearly articulate the vision, strategy and policies
- Eliminate the financial market “Silos”
 - Regulations, regulatory structure, restrictions on business lines
- Create a competitive environment
 - Exchanges: Empower exchanges, encourage privatization, capital formation for technology investment, expansion of products, international access
 - Encourage international entry, remove regulatory hurdles
- Establish a High Level promotional ***Tokyo Financial Center Office***

We would be pleased to meet and to discuss any of the comments presented above or respond to any questions regarding this most important initiative.

July 6, 2007



EXHIBIT

FIA Japan Chapter Members as of July 2007

CORPORATE MEMEBERSHIP

Astmax Futures Co., Ltd.
Atos Euronext Market Solutions (AEMS)
AZSA & Co./KPMG
Baker & McKenzie GJB Tokyo Aoyama Aoki Law Office
Banc of America
Bear Stearns (Japan), Ltd.
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Chicago Board of Trade (CBOT)
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Himawari CX, Inc.
HSBC Securities (Japan) Limited
Intercontinental Exchange (ICE) *ex-IPE
J.P. Morgan Securities Japan Co., Ltd.
Japan Commodity Clearing House Co., Ltd.
Japan Commodity Futures Industry Association
Japan CTA Association
Japan Federation of Commodity Exchanges, Inc.
Kanetsu Shoji Co., Ltd.
Kobayashi Yoko Co., LTD
Man Financial Japan Ltd.
Merrill Lynch Japan Securities Co., Ltd.
Mitsubishi Corporation Futures & Securities Ltd.
Mizuho Securities Co., Ltd.
National Futures Protection Fund, Inc.
New York Mercantile Exchange (NYMEX)
ODK Information System Co., Ltd.
Okachi & Co., Ltd.
Okato Shoji Co., Ltd.
ORIX Investment Corporation
Osaka Securities Exchange Co., Ltd. (OSE)
Patsystems Japan K.K.
Phillip Financials KK
Rainbolt Law Office
Sumitomo Corporation

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The Singapore Exchange Ltd. (SGX)
Societe Generale Securities Tokyo, FIMAT Division
Sydney Futures Exchange Ltd. (SFE)
The Tokyo Commodity Exchange (TOCOM)
Tokyo Financial Exchange Inc. (TFX)
The Tokyo Grain Exchange (TGE)
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