

Agenda for competition among trading venues and alternative trading platforms

Financial Markets Division
Financial Services Agency

Previous regulatory reforms

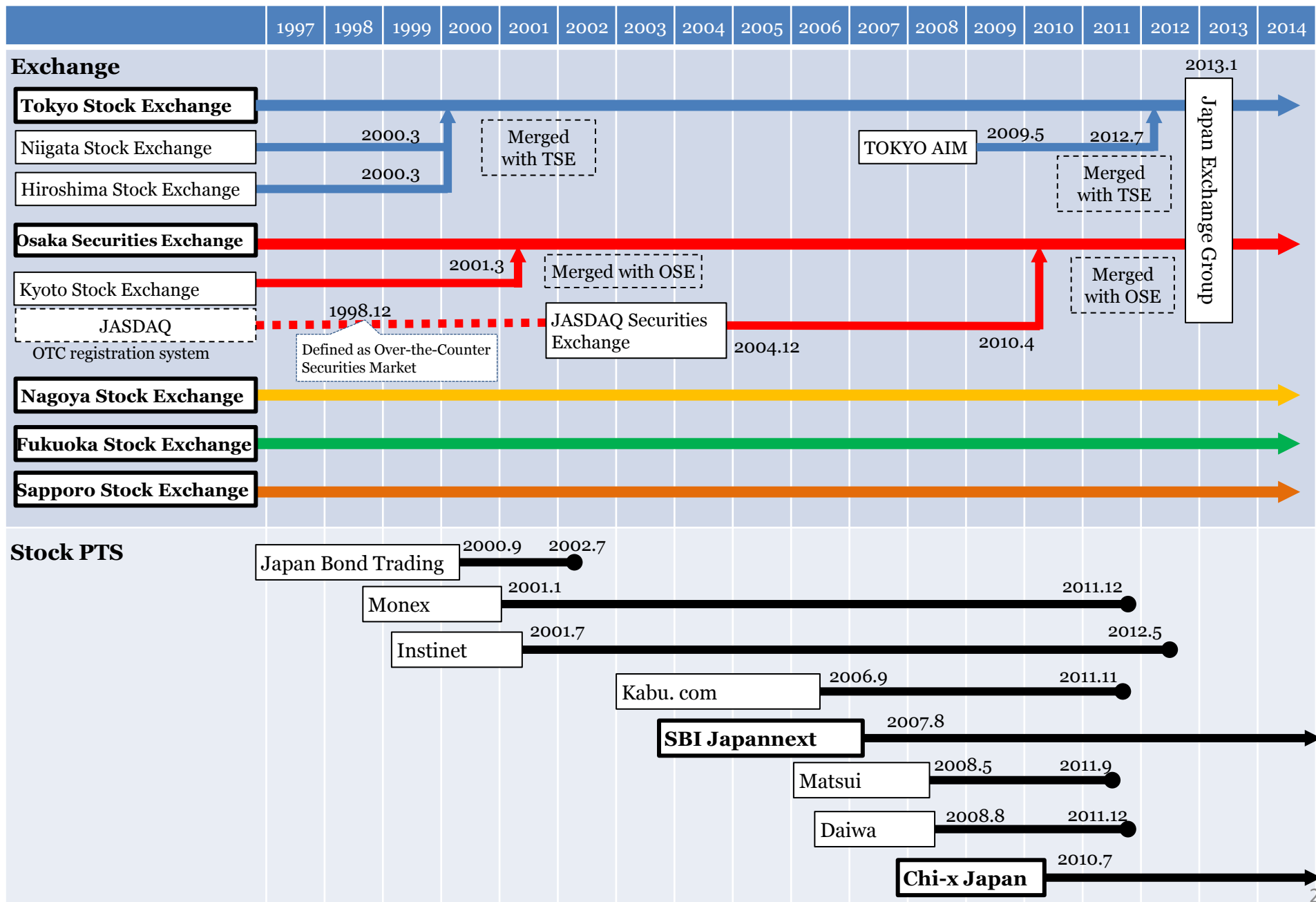
Previous regulatory reforms for the promotion of competition among trading venues (by the Acts for the Financial System Reform in 1998)

1. Abolished the ‘concentration rule*’ and introduced a regulatory framework for Proprietary Trading Systems (PTS) which is equivalent to ATS in U.S. and MTF in Europe.

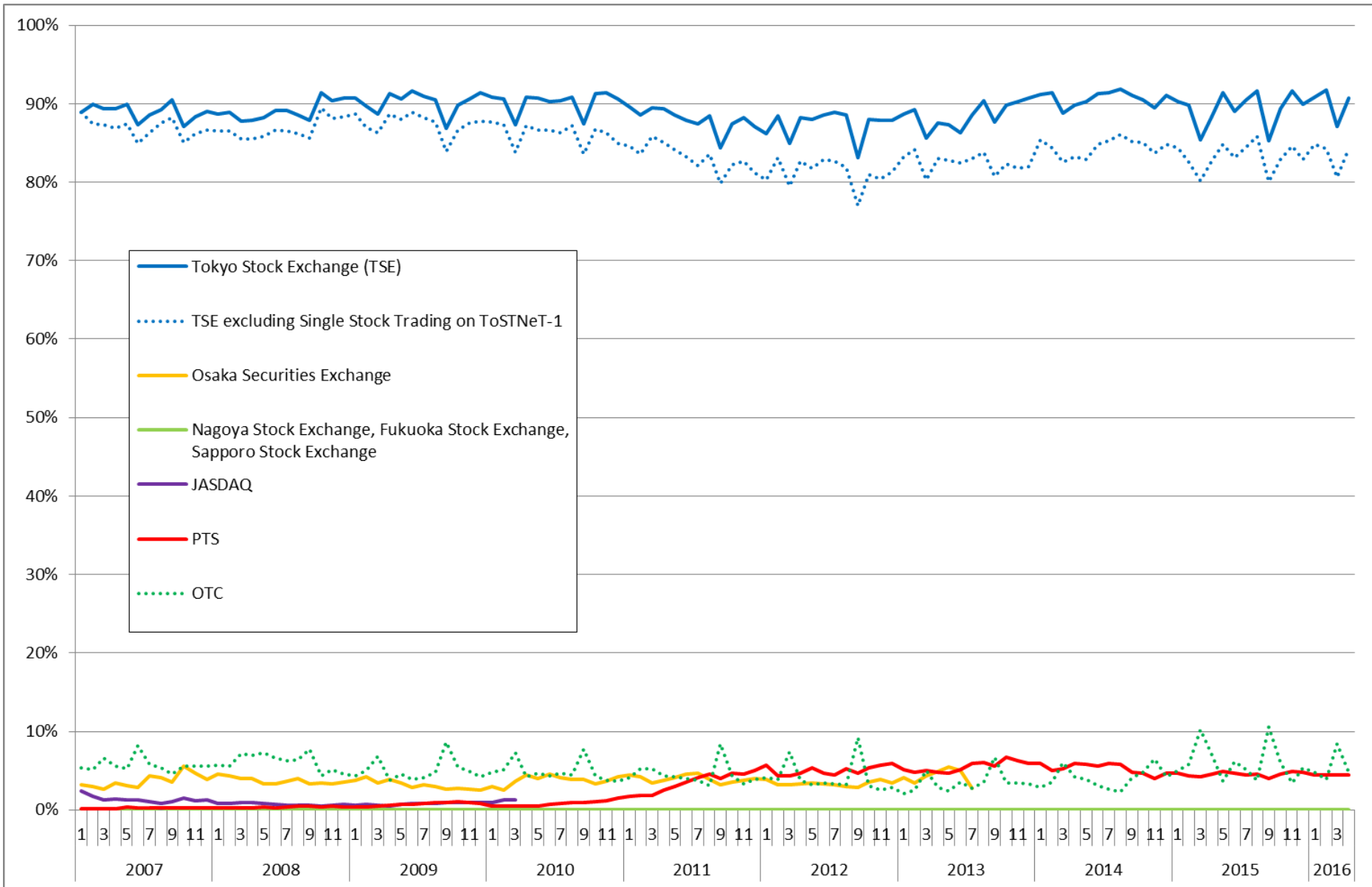
*Concentration rule: Investment firms had been required to route orders only to stock exchanges pursuant to exchange rules.

2. Defined over-the-counter (OTC) registration system as the OTC Securities Market, which is equivalent to the securities exchange market.
3. Put in place a set of rules for trading of unlisted stocks.

Transition of exchanges



Market share of listed equity



Trading value of listed equities.

Source: Websites of respective exchanges and Japan Securities Dealers Association

Proprietary Trading System (PTS)

PTS is an alternative trading platform where matching of a number of trading orders from various brokerage firms takes place in an organized fashion.

<Comparison between stock exchanges and stock PTSs>

	Financial Instruments Exchange	Proprietary Trading System (PTS)
Operator	Financial Instruments Exchange	Financial Services Provider
Approval	Licensing	Authorization
Capital requirements	¥ 1,000,000,000	¥ 300,000,000
Regulations on major shareholders	Restrictions on Holding of Voting Rights constituting 20 percent or more	—
Self-regulatory functions	<ul style="list-style-type: none"> ➤ Examination on the compliance of the members ➤ Surveillance on the members' transactions ➤ Screening the membership qualification ➤ Sanctions against the members (e.g. who breach the rules) etc. 	—
Margin transactions	Permitted	Not-Permitted
Note	—	PTS that reach a certain market share is required to obtain a license to become an exchange.

Pre and post trade transparency (OTC equity trading)

1. Post-trade transparency

➤ In 1998

The Acts for the Financial System Reform introduced the post-trade report/dissemination regime for OTC equity trading.

2. Pre-trade transparency

➤ In 2000

In order to set up PTS, the guidelines for PTS require PTS to disseminate pre-trade information (quote information).

➤ In 2005

The Securities and Exchange Act introduced a regime of pre-trade transparency (report quote information to the Japan Securities Dealers Association (JSDA) and dissemination from the JSDA).

Discussion points

- How the following understandings regarding competition among trading venues should be considered:
 - ✓ “Competition among trading venues is expected to improve the efficiency and enhance the function of the markets as a whole.” (1997)
 - ✓ “In order to promote effective competition among trading venues, the existence of a powerful competitor will continuously incentivize the Tokyo Stock Exchange to optimize management, which will ultimately lead to better governance.” (2003)

- Under the recent environmental changes, including the mergers of exchanges and IT innovation, how should the significance of the competition among trading venues be understood at this moment.

- What lessons can be learned from other jurisdictions, in particular, U.S. and Europe where a large number of trading venues are competing against each other.

Discussion points (cont.)

- In light of the points above, how the significance of the PTS system should be considered at this moment.
While the number of PTSs is decreasing and their trading share is sluggish, there are questions as to whether margin trading should be permitted, considering a level playing field between PTSs and exchanges.
- If margin trading is permitted for PTSs, the following points should be considered
 - ✓ While exchanges provide self-regulatory functions as a market provider, can a similar level of self-regulatory functions of PTSs be expected?
 - ✓ How to evaluate the possibility of a conflict of interest since PTS operator, as a brokerage firm, provides fund/securities to its customers.
- How to consider the significance of requiring pre trade transparency (disclosure of quote information), in addition to post trade transparency? In relation to that, how to consider the meaning of dark-pools?