Summary of Q&A at JPX IR Day 2018
Japan Exchange Group, Inc.

(Held on July 3, 2018)

Vitalization of ETF Market and Approach to Low Latency Trading

Q1: To what extent did the introduction of the low latency trader registration regime influence the ratio of co-location trading? How do you see this co-location ratio changing in the future?

A1: (Kawai) They are currently registering, and we expect approximately 50 to 60 firms to register. We think that such firms already using the Co-Location Service will basically continue to use the services as they do now.
At the same time, under the registration regime, registered traders are required to develop and establish certain frameworks such as those for operational and system management. As such, we will need to pay close attention to firms that will engage in low latency trading in the future.

Q2: What is the impact of the introduction of the ETF market making scheme on trading volume? Will you also tell us about your approach on this?

A2: (Kawai) The main purpose of the scheme is to boost the trading volume of low liquidity issues, so we do not think the scheme will bring about an immediate, large revenue increase. When the ETF creation/redemption process is streamlined and facilitated, we will see more active arbitrage between ETFs and stocks, and this will likely also help high liquidity issues. As such, trading volume will gradually increase as the situation develops.
In addition, in the case of Japan, ETF use by institutional investors is somewhat limited, compared with in the US. Now that the market making scheme has been introduced, we would like to conduct promotional activities to attract more institutional investors to the ETF market.

Q3: In terms of contributing to revenues, ETFs are attractive for JPX, but they are not as appealing as investment trusts to securities firms. Unless securities firms actively promote them, I do not think the use of ETFs will grow. What are your thoughts on this view?

A3: (Kawai) As you rightly point out, even with the market making scheme, if we fail to attract investors to the ETF market, the overall level of liquidity will not improve. As such, in conjunction with the introduction of the scheme, we are tying up with securities firms to conduct promotional activities targeting retail investors.
Moreover, liquidity will improve when we have larger order flows from institutional investors, and securities firms will in turn get more business. As such, aggressive promotional activities for investors are essential.

Q4: If you intend to encourage the take-up of ETFs, which are less profitable than investment trusts to securities firms, they may ask for more attractive market maker incentives to cover lower revenues from their investment trust business. Was there any discussion on this point?

A4: (Kawai) Before introducing the scheme, we discussed the incentive rate and other matters with those who were considering registering as market makers. We will not run the scheme inflexibly, but review it as needed depending on the situation and make it a better scheme.

OSE Strategy for Expanding Product Lineup and Attracting New Investors

Q5: If we compare the 10-year JGB futures trading volumes in FY2012 and FY2017, there does not seem to be a large difference. However, if we compare them by investor category, has the trading volume of Japanese financial institutions dropped and been offset by the rise in foreign investor activity? Are the increases in trading volume in recent quarters also due to foreign investors? If so, why is the demand for trading among foreign investors increasing? Please also share any background information from the perspective of the market structure.

A5: (Tagaya) Concerning 10-year JGB futures, as you rightly point out, we see a general trend where the decline in trading volume by Japanese securities companies and banks has been offset by that of foreign investors. We hear about securities companies and banks that trade cash bonds and bond futures having difficulty trading futures amid diminishing liquidity in the cash bond market. This decline is largely being covered by HFTs and other foreign investors that do not hold cash bond positions but accumulate gains from trading on futures price moves.

Q6: Concerning the field of commodities and the relationship with Tokyo Commodity Exchange (TOCOM), is there any area that JPX can collaborate on, without touching on the topic of a merger?

A6: (Tagaya) In our current relationship with TOCOM, we are their system provider, and we use the same trading platform.
As for the future, while there is nothing to talk about at present, JPX has set out to advance research and discussion of the comprehensive exchange initiative in its medium-term management plan. If we can provide a single platform for trading various products, then a diverse range of investors will stand to enjoy greater convenience, so we will continue our efforts toward realizing this vision.

Response to Global CCP Regulations

Q7: Regarding the capital shortfall of JPY 25 billion required in accordance with the further guidance on the PFMI, can I understand that as a consolidated entity, JPX has no problems with whether there is sufficient capital? Also, with regard to the timeline for resolving this capital shortfall, I believe you can increase the amount of JSCC capital within the corporate group to resolve this shortfall immediately when needed, so could you also throw any light on the likelihood of this being done?

A7.1: (Shizuka) As of the last fiscal year, JSCC recorded profits of slightly over JPY 5 billion, and our basic strategy is to allocate our profits toward gradually covering this shortfall. However, if we need to dip into this portion before we manage to cover the shortfall, then we are also ready. We have just completed an arrangement to acquire the funds from our parent company when needed.

A7.2: (Tabata) On a consolidated basis, the capital we have at the moment is sufficient to also cover this JPY 25 billion shortfall at JSCC.

Q8: The capital requirement for JSCC is estimated to be about JPY 80 billion. With about JPY 5 billion in profits, JSCC's ROE is only slightly over 6%, which falls short of the minimum target of 10% at JPX. How would you explain your continued interest in this business? For example, are there synergies between JSCC and other entities in the corporate group? Due to the size of the capital requirements, will JSCC raise fees accordingly or perhaps withdraw from this business considering it a risk? To put it simply, can you clearly indicate whether this business will be conducted purely in pursuit of revenues and profits, or assessed accordingly in terms of ROE?

A8.1: (Shizuka) As of the end of March 2018, relative to JPY 57 billion of capital, we turned in a profit of about JPY 5.3 billion, which means we managed to maintain ROE close to 10%.

If there is an increase in capital, then there will naturally be concerns over a lower ROE, but JSCC must address any regulatory requirement to stay in the business. The option of withdrawing from the business to avoid a lower ROE will have to be considered as a corporate group. In a vertically integrated value chain spanning multiple processes from trading to clearing, a clearing house is essential. Whether we aim for ROE or business size as a clearing house, the best approach will be something that is considered along with the right balance for the entire corporate group.

A8.2: (Tabata) At JSCC, the clearing business for listed products is much larger than that for OTC derivatives. In a securities transaction, where a transaction is processed from trading through to clearing and settlement, inevitably trading at TSE market would be affected if JSCC fails to function properly. As such, I think we must consider this issue from the overall ROE of the corporate group.

A8.3: (Shizuka) The competitive landscape is very different for listed products and for other transactions. Clearing of listed products goes to JSCC, so the profit margin from this segment is considerable.

On the other hand, OTC clearing is a very competitive business with a strong international competitor, which means that it is not so easy to generate margins.

As such, we ask that you understand that these two businesses have very different revenue bases, and we have managed to turn in more than JPY 5 billion in profits with a capital of JPY 57 billion from these different business.