

Summary of Comments Submitted in the Public Consultation Procedure  
Regarding "Introduction of ETF Market Making Scheme"

Tokyo Stock Exchange, Inc. (hereinafter "TSE") released the outline of "Introduction of ETF Market Making Scheme" on December 21, 2017 and sought public comment until January 20, 2018. The summary of the comments gathered and TSE's responses to the comments are as follows.

No.	Summary of Comments	TSE Response
1	<p>I would like TSE to introduce ETF market making scheme.</p> <p>ETF must be linked to a specific index, however, the market price of many ETFs deviates significantly from NAV or the target index. Such a divergence seems to be due to lack of liquidity. If this situation is not improved, the market price of ETFs tracking similar indices will not be trusted at all.</p> <p>I hope that by introducing this scheme, TSE will improve the credibility of TSE itself and TSE listed ETFs. Also, in the future, we hope that TSE will not approve the new listings of ETFs whose price are not securely linked to the target index.</p>	<p>Thank you for your valuable comments on this scheme.</p> <p>As you pointed, in some ETFs with few quoting or trading, insufficient linkage with the target index, and situation where the market price deviates from NAV have been observed. We will introduce this scheme in order to improve this situation.</p> <p>Since the market price of ETFs fluctuates not only by the variation of underlying asset price but also by the balance of supply and demand, complete linkage may not be guaranteed, however, higher correlation will be expected between the ETF price and underlying asset price with continuous quote obligation imposed by this scheme.</p> <p>Through this kind of changes, TSE will strive to facilitate the market environment that enables investors to buy and sell at an appropriate price at any time by improving the liquidity of the ETF market.</p>
2	<p>What are the criteria of ETFs subject to this scheme and ETFs designated as ETFs for diversified investment under this scheme?</p> <p>For example, will market-neutral type ETFs which are hedged using index futures be subject to this scheme and be designated as ETFs for diversified investment?</p>	<p>Since the target of this scheme is all ETFs except leverage and inverse type, the market-neutral type is also included to the target of this scheme.</p> <p>With respect to ETFs for diversified investment, TSE designates indices that are considered essential for long-term and diversified investment, and ETFs linked to the indexes are named as ETFs for</p>

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		<p>diversified investment.</p> <p>Please refer to the document to be released soon for which ETFs are designated.</p>
3	<p>We appreciate the efforts made by the TSE to consult regarding the introduction of the ETF Market Making scheme.</p> <p>We recognize the Scheme as a catalyst for renewed competition in the asset management space and structural improvements in the product and market design. Some of these improvements, such as the ones listed below, will also increase the chance of success of the Scheme.</p> <ul style="list-style-type: none"> <li>- Smaller creation and redemption sizes <p>Market Makers will need to obtain inventory in less liquid ETFs through creations in order to sell units to investors. The minimum creation and redemption sizes of less liquid ETFs in Japan are disproportionately large compared to the expected trading volumes and quoting obligations in these products. For example, the size of quoting obligations is less than 10% of the median creation unit size. Therefore, to offer ETFs to investors, a Market Maker may be left holding more than 10x their desired inventory. This will significantly increase the inventory costs, financing requirements and position hedging risks for Market Makers. We expect this to limit the number of ETFs that Market Makers are willing and able to cover as part of the Scheme. Smaller creation and redemption sizes would alleviate this problem and invite broader participation from more Market Makers across more products.</p> </li> <li>- Availability of cash creation and redemption (not only physical) <p>Physical creation or redemption requires the Market Maker to execute and settle trades in the underlying assets of the ETF, creating additional administrative and financial burdens. Not all ETFs currently offer a cash creation or redemption mechanism. A cost-effective and efficient creation and redemption process ensures liquidity and fair pricing of ETFs.</p> </li> <li>- Development of the ETF lending and borrowing (SLB) market</li> </ul>	<p>Thank you for your valuable comments on this scheme.</p> <p>We will continue to address the issues critical to the Japanese ETF Market which you pointed with market participants.</p>

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	<p>Access to a liquid and efficiently priced SLB market is a key inventory management and cost-reduction tool for Market Makers. The concentrated nature of ETF ownership in Japan and the current absence of a well-developed SLB market will complicate or even render impossible the creation of an efficient market making.</p>	