

Action Program for Strengthening the Functions of the Cash Equity Market

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Tokyo Stock Exchange, Inc.

As the environment surrounding the market changes and evolves, Tokyo Stock Exchange, Inc. (TSE) continues to work to not only provide stable market operations and maintain the reliability of its market, but also address the diverse needs of investors. As such, TSE deems it necessary to pursue improvements to its trading rules and services, and will work on specific measures based on the approach described below.

I. Fundamental Approach

The stock market has been experiencing drastic change in recent times. From increasing automation and speed of trade executions to the shift toward passive investment, the execution needs of domestic and foreign investors are growing more diverse, and increasingly sophisticated services are being developed to capture this changing demand. For the Japanese stock market to remain attractive to investors, it is imperative for TSE to respond to these changes in the market environment in a timely and appropriate manner.

TSE has been pushing forward on corporate governance in Japan alongside efforts toward Japan's Stewardship Code, and has also taken measures, including reviewing its cash equity market structure, improving its trading rules, and strengthening its market infrastructure. In a market environment that is constantly changing, TSE recognizes the need to continuously implement further improvements with a view to improving the convenience and reliability of the market.

Therefore, TSE has compiled an "Action Program for Strengthening the Functions of the Cash Equity Market" mainly comprised of matters related to the improvement of the reliability and safety of the market, development of an environment to facilitate trading by investors, and consideration of future trading rules in light of the changing market environment. TSE will implement the measures as soon as possible with the aim of making the market even more convenient and attractive to investors.

While some of these measures will henceforth be deliberated in detail, there may also be other measures that are desirable. TSE will consider them together with market users as needed and work to continually develop the environment for implementing such measures with a view to providing a highly convenient market infrastructure for all investors to use with confidence.

If any specific measure involves rule revisions, when the details of such revisions have been determined, they will be released to gather feedback in the form of a public comment, etc.

II. Outline of Measures

1. Improving the Reliability and Safety of the Market

Amid the advancement of automated trading and high-speed trading as well as changes in the market structure due to increasing market shares of PTSs and dark pools, etc., we will introduce new regulations and conduct more sophisticated trade monitoring and market surveillance to appropriately improve the reliability and safety of the market.

(1) Introduction of market access rule, etc.

- Considering the current situation where investors, securities companies, and TSE are closely linked to each other with the advancement of automated trading and high-speed trading, in light of ensuring appropriate price formation in the market and avoiding systemic risk, to further improve the stability and reliability of the market, TSE will require trading participants to have direct and exclusive risk management control over customer order restriction and measures.
- Moreover, TSE will require trading participants to introduce functions to deter the placement of new orders to the TSE market in such events as a system glitch. TSE will also specify that, if an order triggers the risk limit, etc. set by the trading participant, the trading participant must appropriately handle such order in its system. <Scheduled to be implemented in early 2021>

(2) Introduction of self-trade prevention function

- With respect to self-trade (transactions involving buy and sell orders from the same investor), which may occur in program trading, even though it may not be intentional, such instances may raise suspicions about wash trades, etc. As such, TSE will introduce a self-trade prevention function to deter such transactions from being effected. <Scheduled to be implemented in FY2021>

(3) Implementation of sophisticated trade monitoring and market surveillance

- Due to the increasing sophistication of automated trading and high-speed trading, TSE will accumulate the trade data of entities engaging in high-speed trading to understand the actual trades in detail and conduct in-depth trade monitoring. For market surveillance, we will also deploy more sophisticated methods such as incorporating artificial intelligence.

(4) Response to regulations on dark pools

- Based on the discussions at meetings of the Working Group on Financial Markets under the Financial System Council, TSE will develop systems and frameworks to understand the actual

situation regarding dark pools.

- For order placements on the ToSTNeT market, TSE will introduce a flag to identify orders routed from dark pools. Moreover, brokers that route customer orders to dark pools will be required to retain data to allow for post-hoc verification on the state of price improvements. In conjunction with this, TSE will also verify the state of price improvements. <Scheduled to be implemented in August 2020>

2. Developing an Environment that Facilitates Investment

Alongside increasingly diversified and sophisticated trading needs comes the need for diversified, long-term investment and a broadening of the new investor base. In order to accurately respond to such needs, TSE will develop an environment that is highly convenient for various investors to facilitate trading at better prices by measures including improving its trading rules and providing new methods or channels as well as information.

(1) Vitalizing the ETF market

- Since the market making scheme for the ETF market was introduced, liquidity in the market has increased. TSE will aim to further improve liquidity by means such as expanding the scope of eligible issues, primarily targeting issues for which there is high demand from investors for market making. TSE will also further review the scheme with a view to increasing convenience for investors. <Scheduled to be implemented in FY2020>
- In addition, in response to the increasingly diverse needs for trade execution among investors, TSE will consider providing market platforms, such as providing a Request for Quote (RFQ) function for the ETF market, to accommodate changes in the environment and investor needs.

(2) Promoting the appeal of investment in individual stocks to retail investors

- Amid the trend toward program trading and passive investment, the role of retail investors, who make a variety of investment decisions and consider different time horizons when trading stocks, is quickly becoming more important in the stock market in terms of unearthing corporate value and price formation.
- TSE will collaborate with market players and related organizations to reach out to retail investors to promote the appeal of investing in stocks (i.e., capital gains, dividends, shareholder benefits, and deeper interest and engagement in corporate activities such as attending general shareholders meetings). At the same time, TSE will engage in initiatives to foster a proper understanding of the insider trading regulations to prevent retail investors from not investing in stocks due to unfounded fears of violating such regulations.

(3) Developing new methods or channels for new investors

- Listed stocks present a particularly high obstacle to young adults looking to build assets. Under

these circumstances, from the viewpoint of broadening the new investor base, TSE will consider the introduction of systems and frameworks to make it easier for individuals to invest, such as through a trust-based small-lot investment program.

- TSE will consider the diversification of trading participants based on the situation where some market players expect that securities companies deploying new business models will succeed as they provide new methods or channels mainly for new, young investors.

(4) Optimization of tick sizes

- As a venue that all investors can access and trade, TSE will optimize its tick sizes with a view to developing an environment where retail investors, long-term investors, and other investors can execute trades at better prices.
- Specifically, TSE will optimize the tick sizes for medium liquidity stocks and some ETFs that, due to the tick sizes, are costly to trade from a global perspective.
- When reviewing the tick sizes, TSE will place emphasis on simplicity for investors and avoid creating excessively small tick sizes. <Scheduled to be implemented in FY2020>

(5) Enriching information for investors

- With respect to information deemed useful from the viewpoint of trading convenience, risk management, etc., such as data on margin transactions and short selling, TSE will examine the usability, etc. of such information and enrich it as needed.
- Information available only in Japanese is a barrier to investment from overseas. As such, from the viewpoint of increasing convenience for overseas investors and facilitating their investment in Japanese stocks, TSE will verify the usability, feasibility, and such aspects of disseminating, in English, transcripts of listed company IR events and analyst reports on small- and medium-cap stocks that use alternative data.

(6) Enhancing the convenience of margin transactions

- In order to enhance convenience for investors, TSE will consider improving the rules for margin transactions, including optimizing the rules by such ways as improving the guidelines for designating issues subject to daily publication and regulatory measures.

(7) Addressing various execution needs in the ToSTNeT market

- With the diversification of trading methods, there is demand for designating a specific settlement date at the time of the trade execution. As such, for single stock trading and basket trading, in addition to the current T+2 settlement cycle (third business day counting from the trade day), TSE will introduce rules that allow the flexible setting of settlement dates.
- Based on the situation of increasing VWAP (volume weighted average price) transactions, TSE will allow for VWAP transactions between different customers (entrusting investors) for single

stock trading (limited to cross transactions within the same trading participant). <Scheduled to be implemented in August 2020.>

3. Considering the trading rules for the future in light of changes in the market environment

TSE will review the trading rules for the future in order to respond to the diversification of investor needs and trade execution, as well as the constant changes in the market environment and structure itself.

(1) Assessment of trading rules amid the shift toward passive investment

- TSE has broadened the executable price range at the closing auction in the afternoon session to facilitate the formation of closing prices even when there is a concentration of supply and demand. TSE will continue to assess the effects of this measure as the shift toward passive investment progresses.

(2) Study on the next-generation market

- TSE will consider the trading rules, services, and infrastructure for the next generation, taking into account comments from market participants and overseas market trends.