

Notes on Media Briefing by Akira Kiyota, Director and Representative Executive Officer, Group CEO, Japan Exchange Group, Inc., at Kitahama, Osaka on January 29, 2016

Thank you for taking the time to attend this conference today.

I am Akira Kiyota, Group CEO of JPX.

The press conference is usually transmitted live from Tokyo, but today I will directly speak to you here.

There are two items on the agenda today.

First, I would like to go over the financial results for the 3rd quarter for the fiscal year ending March 2016.

Operating revenue was JPY 85.2 billion, operating income was JPY 51.7 billion, and net income attributable to owners of the parent company was JPY 35.5 billion.

Average daily trading value for cash equities reached approximately JPY 3.38 trillion, a huge year-on-year increase of 24% from JPY 2.72 trillion.

Derivatives markets showed a firm tone with average daily trading volume of approximately 218,000 contracts (a 21% year-on-year increase) for Nikkei 225 Futures and about 90,000 contracts (an 11% year-on-year increase) for TOPIX Futures.

As for expenses, system maintenance and operation expenses and depreciation decreased mainly due to the integration of systems. As a result, operation expenses decreased by JPY 3.7 billion (9.4% year-on-year).

In this way, year-on-year revenues increased and expenses decreased. As I pointed out earlier, operating income was about JPY 51.7 billion, and net income attributable to owners of the parent company was about JPY 35.5 billion. Both incomes remarkably increased by approximately 30%.

The second item is the scheduled date for the official launch of Next J-GATE.

OSE is preparing for the launch of Next J-GATE together with related parties.

So far, preparations, including various tests, are proceeding as scheduled. Therefore, OSE has decided to launch Next J-GATE on July 19, 2016, the Tuesday following a three-day weekend.

We will begin connection tests with trading participants, including securities companies, in March and conduct migration rehearsal nearly under the production environment in April. On July 17, we will make a final decision on whether to launch Next J-GATE and announce the decision on the same day.

In tandem with the introduction of Next J-GATE, OSE will launch TSE Mothers Index Futures, JPX-Nikkei 400 Options, TAIEX Futures, and FTSE China 50 Index Futures

We will also extend our trading hours. Specifically, we will extend the end of Night Sessions from the current 3:00 a.m. to 5:30 a.m. In addition, we will move up the opening time for index futures from 9:00 a.m. to 8:45 a.m.

Moreover, we will introduce a non-cancel period for some products and provide risk management tools. During the non-cancel period, orders cannot be corrected or cancelled.

Needless to say, system capacity and processing speed will be improved. I believe this will contribute to ensuring further system stability.

Taking this opportunity, I would like to express appreciation for everyone who has cooperated with us toward the launch of Next J-GATE and for the continued support of and cooperation with system tests and other preparations in the future.

[Q&A]

Q: I have two questions. The first one is about market conditions. Since the beginning of the year, stock price declines and concerns over the real economy have continued, primarily due to China's economic slowdown. What are your thoughts on the outlook of the economic climate and market conditions, taking into account the BOJ's decision to introduce negative interest rates? My second question is about derivatives. Today you announced the go-live date for Next J-GATE. What is the medium- to long-term strategy for growth in the derivatives market?

A: The market saw violent fluctuations due to unexpected changes in monetary policy. As you mentioned, the market has seen unexpected price movements since the beginning of this year.

The market experienced six consecutive days of declining stock price indices for the first time after World War II. This movement was triggered partly by slowing Chinese economic conditions and wild fluctuations in the Chinese stock market. In addition, investors and market participants were not able to estimate how great an impact the plummeting crude oil prices and outflow of money from

emerging countries (to the US), which was brought about by the FRB's interest hike in December, would have on the markets and economy. Under these circumstances, investors shifted their money to bonds, which are relatively safer, or Yen, in the form of risk-off, which I think has caused this market disruption. Today's announcement of negative interest rates by the BOJ will not immediately have a positive effect on the current situation. However, I sufficiently feel the BOJ's sense of crisis in its policy measures.

If we look only at the Japanese economy, the market ended last year on expectations that Abenomics, what is supporting Japan's economy, did not get out of order and that, therefore, the market would be okay. However, when the New Year came, the market tumbled, surprising everyone and suggesting that the adverse effects of a slowdown in the Chinese economy were greater than expected.

All of these are related factors. The large economic slowdown in China has reduced demand for resources, and such reduced demand dragged down prices of crude oil and other resources such as iron, steel, and coal. This situation generated an expectation that emerging economies, the exporters of resources, might incur significant damage, which led to a risk-off stance. In addition, assuming that the US would absorb money, some investors fell into a panic and started selling. Moreover, there are concerns that investors might sell off stocks globally, particularly in the course of managing assets for huge amounts of foreign currency reserves in resource-exporting countries. Some say that such sell-offs are already taking place. These circumstances also have an impact on stock markets. But, I am not sure whether these situations are bad or not.

The FOMC, which closed two days ago, hinted at the possibility that they might continue raising interest rates this fiscal year. They were looking back to the slowdown in the US economy at the end of the year when speaking of increasing the interest rates four times in a year. This indicates that they are not guaranteeing that there will be four interest rate hikes, but that they will implement monetary measures while looking at the actual state of the US economy. Some calm returned to US markets after these statements. Moreover, the BOJ is posing itself to implement quantitative and qualitative easing, as well as interest rate measures, which will beef up the stability of the Japanese economy. This can have a positive and negative impact on Japanese corporate performance and other aspects. If we found ourselves in a situation where the yen was appreciating, that might hint at a little headwind, but there is no

guarantee that today's level can be maintained. As the yen is hovering at around the upper half of JPY 100 against the US dollar, if rates return to the JPY 120 to approximately JPY 121 range, then we would not be able to say the yen is strong. In addition, the 10-year interest rate is 0.13%, a record low. These circumstances will not be bad for Japanese companies.

Some point out that the low prices of crude oil can rekindle a deflation mindset. Low crude oil prices provide significant advantages to companies that consume large amounts of crude oil, like JAL, whose business performance is reportedly picking up today. As far as natural resources are concerned, Japan relies 90% on imports. As such, the low oil prices also constitute positive factors for the Japanese economy in many ways. So I think we need not be so worried.

With the additional easing, the BOJ will introduce policy measures to further drag down yield curves, including 10-year interest rates. Due to recent plunges, PE Ratio for Japanese stocks decreased to 13–14, which largely elevated dividend yields. As there are now large differences between bond yields, i.e. fixed income, and dividend yields from equities, stock investment is becoming much more appealing. This means that now could be a great opportunity to shift financial assets from savings to investment and that it would not be surprising if there was an increase in enthusiasm for stock investment. In this respect, I think that the negative interest rate announced by BOJ Governor Kuroda, a surprising policy measure, will prove advantageous to the stock market as a whole.

Let me go on to the second question related to the growth strategy in the OSE derivatives market, as related to Next J-GATE. With the J-GATE upgrade scheduled for June, processing speed will significantly increase by nearly 20 times that of the current system.

One of the characteristics of the derivatives market is that there is a high concentration of transactions for a small number of issues. As such, high processing speed is a must. In the case of TSE's arrowhead for cash equities, transactions are dispersed over 3,500 issues. That means that transaction concentration is far lower than that of derivatives. Therefore, the arrowhead renewal last year focused more on risk management functions than on speed.

For Next J-GATE, we will not only introduce risk management functions, but also be significantly increasing processing speed. Next J-GATE will have the capacity to swiftly handle a high concentration of transactions, orders, and executions.

These improvements will allow us to launch new products such as TSE

Mothers Index Futures, JPX-Nikkei 400 Futures, TAIEX Futures, and FTSE China 50 Index Futures.

As a derivatives market operator, we will work to introduce new products. In the future, we will tackle various challenges to become a Comprehensive Exchange. In that sense, our system will have the capacity to handle much more, namely commodity derivatives. However, it will not be limited to just that; Next J-GATE will also be able to effortlessly handle such products as derivatives related to interest rates, foreign currencies, and whatever else arises as products the Exchange would need to handle at the time.

In terms of capacity and the like, we will be able to flexibly accommodate new products related to commodities, interest rates, foreign currencies, and those products we see as necessary for a derivative market operator to provide in the future.

TOCOM will start using Next J-GATE in around September this year. We have placed our expectations on building a truly strong collaborative partnership with TOCOM.

Q: Please comment on the prospect or status of the development toward a Comprehensive Exchange.

What role should JPX play in the development of such an exchange?

What is the current status of your cooperation with TOCOM and Osaka Dojima Commodity Exchange (ODE)?

A: The concept of establishing a "comprehensive exchange" was decided by the first and second Abe cabinets, and the government policy covers the realization of a Comprehensive Exchange as soon as possible as part of the growth strategy. Commodity derivatives are under the jurisdiction of the Ministry of Economy, Trade and Industry (METI), and financial derivatives are under the jurisdiction of the Financial Services Agency (FSA).

As METI seems to be working toward their concept of a comprehensive energy market for TOCOM, I think it will take some time for this Comprehensive Exchange concept to come to fruition. Alliance or integration with TOCOM in the future is a way for us to achieve our goal of becoming a Comprehensive Exchange, but we also have the option of working on commodity derivatives on our own. Regardless, we would like to proceed to materializing the concept of a Comprehensive Exchange.

In fact, major global exchanges such as the CME or ICE, under which lies the NYSE, are comprehensive exchanges. I think that few countries have separate jurisdictions over financial exchanges and commodities exchanges.

If we look at it from the perspective of realizing a Comprehensive Exchange, we can expect that TOCOM's using the OSE trading system from around September this year will further deepen our cooperative relations with TOCOM.

Q: I have two questions. The first question is about the placement of circuit breakers. At the beginning of January, Chinese authorities abandoned the circuit breaker system after it was used for four days. The media reported that questions were raised about the safety and reliability of Chinese exchanges as market operators. Could you comment on the situation in China?

The second question is about the reliability of the system in Japan. How reliable is it?

A: China introduced the circuit breaker system after stock prices fell last August.

Under the system in China, the trading of all issues halts for a certain period of time after a 5% drop in value and for the rest of the day after a 7% retreat, while in the U.S. where a similar system has been implemented, the trading will halt for the rest of the day in three tiers, which means complete suspension happens when the fluctuation rate reaches 20%. Calculated simply, the entire trading in China halted for the rest of the day with only about one third of the fluctuation rate seen in the U.S. In the case of China, it occurred at the beginning of the year, when the rate reached the 5% limit. Trade halted and resumed, and then, when the rate soon reached the 7% limit, trade halted for the rest of the day. We assume regulators abolished the system after they determined that the circuit breaker system had not fulfilled its function to give traders time to reconsider their transactions.

Such circuit breaker system is not implemented in cash equities trading in Japan. Daily price limits are set for each issue to curb large price volatility.

As for index futures and options trading, however, we have circuit breaker rules. For example, the trading of Nikkei 225 futures and TOPIX futures halts for a certain period of time when the fluctuation rate of price limits reaches 8% of the usual price limit. The trade will halt for a certain period of time and resume with the rate being expanded to 12%. When the fluctuation rate reaches 12%, trading will halt again, and resume with the rate of 16%. The rate will be

expanded through several stages. The circuit system for index futures and options provides sufficient safety.

Q: My question is in relation to the work you've been doing on strengthening the governance system in listed companies over the past few years. The Corporate Governance Code requires companies to appoint multiple outside directors. When I talk with corporate managers here in Osaka, they say that there are fewer experts—that is former top managers, lawyers, or scholars—in Osaka than in Tokyo, making it hard to find appropriate candidates. In addition, I have the impression that more corporate managers here feel uncomfortable with building their fundamental approach within that framework, since they believe that complying with the principles just in form would not prevent misconduct. I would like to hear your comments on the current corporate governance system, including the issue of regional differences in human resources.

A: The Corporate Governance Code was implemented last June. Companies that settle accounts for the business year in March submitted a governance report by last December, and we released the outcome the other day. One of the principles that many listed companies chose to explain instead of comply is appointment of more than two independent outside directors. I am sure that there are some companies that have yet to comply, but most of them explained that they would determine whether they would comply or not by the next fiscal year, and few companies indicated that they would not comply. Under the Corporate Governance Code, it is the first time that Japanese companies are required to appoint multiple independent outside directors. When you consider what it means for an outside director to be independent, some may say there are not enough appropriate candidates in Osaka. This could be an issue for not only Osaka but also for other cities across the country. There are many companies in Tokyo, but that does not mean that Tokyo is the only place with a large number of people suited to stand as outside directors.

I don't think you need to look for candidates only among former corporate managers or top managers. BODs should be diversified with members of different backgrounds. Selecting someone who voices candid opinions with a free way of thinking is essential. If outside directors view something strange with an outsider's eyes, they can point out that it is strange. People from the outside will be able to point out things that they view as slightly unusual,

irrespective of whether those things are regarded as normal internally.

We expect outside directors to contribute to preventing managerial risks to enhance corporate value. I hope that many companies will think outside the box and choose outside directors from among people of a wide range of backgrounds. There are some people who have not become corporate managers even if they are qualified. Such people can have different views and good advice on corporate management.

It is also important for corporate managers to explain the true nature of their management to outside directors on a daily basis.

Q: May I ask once again about your view on the decision made by the BOJ to adopt negative interest rates? Do you feel it will have a positive impact or negative impact on the market? Or, do you think we need to wait and see?

A: The way I see it, adopting negative interest rates should not be surprising, since the European Central Bank and other central banks in Switzerland and Denmark have already introduced such a policy. In Japan, many people have opposed the effects of the negative interest rate policy so far. As such, the policy seems to have taken everyone by surprise.

The BOJ has provided financing by purchasing JPY 80 trillion of government bonds a year. A large amount of money has been accumulating as excess reserves in the current account of financial institutions at the BOJ, and the money was originally provided by the BOJ to financial institutions.

As such, applying an interest rate of 0.1% to excess reserves derived from the quantitative easing policy was assumed to serve as a certain level of subsidy to the banks.

Therefore, the BOJ has devised the negative rate system by dividing reserves into three tiers: reserve deposits of which a minimum amount is requested; slightly excessive reserves; and excessive reserves that are unnecessarily accumulated. They will be applying a positive, zero, and negative interest rate to each of these tiers respectively. In short, negative rates will be applied to reserves that have been unnecessarily piled up.

In this regard, the BOJ articulated its intention by pushing back the assets that were returned from the market after they had furnished them.

We can assume the BOJ is expecting the money to return to the market if financial institutions do not want to reserve it or find any other way to use it.



The question of whether there is a demand for borrowing in the industry will be an issue. Financial institutions will need to seriously consider how to use the assets that are pushed back by the BOJ.

Financial institutions, thus far, have surely and safely reserved assets on the BOJ and, though minimal, have received interest. However, reserving assets with no plan will cost money from now. In that sense, the negative interest rate policy will greatly affect financial institutions.

From an investor's point of view, when share prices are low in a situation where there are many stocks with very high dividend yield, bonds yields will decrease or go negative, which may cause asset transfers. In that sense, the investment market may change.

In fact, the Japanese currency, having a low interest rate, is selling now. This move may be seen only for the short term. However, the yen has weakened from below JPY 80 to JPY 125 since Abenomics launched. This monetary policy has continued to prevent the yen from appreciating in this respect. As such, a relatively weak yen will still have a positive impact on the performance of Japanese companies, especially those that generate revenue overseas or export products from Japan.

Issues posed by adopting the negative interest rate policy will be discussed in many ways. One of the simple questions may be to what extent banks will pass on the costs to their lending rate.

However, I don't think banks would do so, since few companies and individuals take out loans. If they do, loans offered by banks will decrease further. We will see what issues arise.

Q: Could you share your views on the relationship with TOCOM in the future?

A: In September, TOCOM will start using J-GATE once the system is upgraded. When the cooperative relationship between TOCOM and JPX is established, both sides will be able to use the system with no complications. However, given the circumstances at METI, it is clear that the Comprehensive Exchange concept will not be realized immediately. We will examine how we can cooperate to eventually achieve a Comprehensive Exchange.

Q: Could you talk about any progress with the ODE in terms of the Comprehensive Exchange concept? No details were given on the matter when

you referred to the topic.

A: The ODE is under the control of the Ministry of Agriculture, Forestry and Fisheries. The rice they handle will not be included in the concept for the time being. This does not mean that the ODE has determined to be excluded, but there is an issue of how the actual receipt and delivery of commodities should be handled. As such, the ODE is not part of the concept for now.