Summary of Public Comments on "Optimization of Tick Sizes for ETFs, etc. and Other Revisions"

November 19, 2021

Tokyo Stock Exchange Inc.

Tokyo Stock Exchange (TSE) published "Optimization of Tick Sizes for ETFs, etc. and Other Revisions" on July 2, 2021 and sought public comments until August 1, 2021. For those who responded to the consultation, we deeply appreciate your cooperation with our work on these issues.

A summary of the public comments on the security deposit rate for margin transactions of leveraged products and TSE's responses to each comment are as below.

(Please see the link below for a summary of public comments on optimization of tick sizes for ETFs, etc. and TSE's responses to each comment.)

https://www.jpx.co.jp/rules-participants/public-comment/detail/d2/nlsgeu000005ndzc-att/english.pdf

| No. | Summary of comment | TSE's response |
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| 1 | - Leveraged/inverse ETFs play an important role in the stock market at the moment in terms of, among other things, providing liquidity and as a means for beta adjustment for both institutional investors and retail investors. We think it highly likely that this role would be significantly impaired by these revisions. We think this is evidenced by the fact that there is a lot of trading in leveraged/inverse ETFs.<br>– While a leveraged ETF has the effect of increasing range of price movement relative to its underlying index, under the current rules the listing examination examines whether a product would have excessive | – These revisions will be made in line with the amendment of the "Cabinet Office Ordinance on Transactions prescribed in Article 161-2 of the Financial Instruments and Exchange Act and Security Deposits for Said Transactions" by the Financial Services Agency.<br>– The implementation date will be January 10, 2023, taking into consideration the comments suggesting that (1) a sufficient period is required for making investors aware of the revisions to the security deposit rate, and that (2) |

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| | volatility as a result of that, and we think that this controls excessive volatility. In addition, since the price volatility risk is not especially high compared to individual stocks, we think the revisions will have little effect on reducing excessive leverage, which is their purpose. Taking into consideration the leverage regulation in the U.S., since the maximum leverage is limited to two times in Japan, we think it possible to reduce excessive leverage through listing examinations and other means and therefore we see little need to change the current rules.<br>– Based on the above, we are against the rule revisions since we think that as well as not achieving their original purpose, the proposed revisions could hinder the sound development and vitalization of the Japanese stock market.<br><br>– In addition, as we can see from, for example, the fact that the maximum amount of losses from a purchase on margin is limited to the amount of credit extended to a customer under said margin transaction regardless of whether the traded issue is leveraged or not, leveraging indices that track ETFs is not the same as leverage factors in margin transaction, and they have very different meanings from the viewpoint of risk. In this regard, please explain why you came to the conclusion that trading leveraged ETFs on margin leads to "excessive leverage factors" | financial instruments business operators need time for changing their systems and other related arrangements.<br>– Please note that the increased security deposit rate will be applied to the calculation of withdrawable amounts for new sales and purchases via margin transactions established on or after the implementation date. |

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| | – Implementation date<br>– Since we trade the issues subject to these revisions regularly, and security deposit rates for the same transaction will differ considerably before and after the revisions, this will have a significant impact on investors, and will require securities companies to adjust their systems, alongside other things. Given that a preparation period is necessary for making investors fully aware of the revisions and to allow securities companies to respond, we do not think that an implementation date of April 2022 allows enough time. We request TSE to reconsider the implementation date taking into consideration the amount of time required for sufficient prior notification and preparation.<br><br>– Range of application<br>– If the rate is applied to the calculation of the amount of security deposits that may be withdrawn (hereinafter referred to as "withdrawable amounts"), different kinds of administration will be required from that under current measures for raising the security deposit ratio. As a result, securities companies will be required to make substantial changes to their systems, the additional costs for which could eventually be passed on to the investors who use securities companies. | |

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| | – On the other hand, even if TSE were to impose the same kind of measures as the measures for raising the security deposit ratio, without applying it to the calculation of withdrawable amounts, we think TSE could still fully address the investor protection purpose without losing the aim of the revisions. Accordingly, we request TSE to reconsider the revisions so that they are not applied to the calculation of withdrawable amounts, in order to avoid an increased burden for investors by staying away from unnecessary system changes at securities companies. However, even if this change is made, we request TSE to reconsider the implementation date since a certain level of system changes will be required. | |
| 2 | – Item 2: Security deposit rate for margin transactions of leveraged products<br>– It was stated that the changes will be "applied to the rate of security deposits for calculations of withdrawable amounts and new sales or purchases via margin transactions on or after the implementation date", but can you confirm the handling of existing open interest which is established prior to the implementation date of April 2022?<br>– Is it correct that the security deposit rate for open interest that is established prior to the implementation date will continue to be 30% for calculating security deposits even after the implementation date, | |

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| | and that this will be 60% only when we calculate the withdrawable amounts on or after the implementation date? | |
| 3 | – For "2. Security deposit rate for margin transactions of leveraged products", it is stated that the new security deposit rate will be applied to the calculation of withdrawable amounts. In this regard, it is correct to understand that the increased security deposit rate will be applied to open interest that has been held since before the implementation date of April 2022? | |
| 4 | – If we need to change the default security deposit rate for each individual issue according to its leverage characteristics, a large-scale system development will be required even though the range of issues subject to the changes is limited. For the purpose of changing systems at each securities company, is it correct that we should show the relevant ETFs as if they are continuously under the measures for raising the security deposit ratio (e.g. raised to 60% for a 2x leverage ratio), rather than displaying default security deposit rates for relevant issues separately for each leverage ratio?<br>– If we need to respond to this issue along with the issue of U.S. stocks margin transactions, scheduled to start in July 2022, we are afraid that human resources inside and outside the company will be under considerable strain. In addition, in the worst-case scenario, if a system | – Since the revisions are different from the measures for raising the security deposit ratio, as long as customers have definitely deposited the required amount of security deposit with the recognition that this is for leveraged and inverse ETFs and ETNs, we do not see any problems with responding to the revisions using existing systems (for the measures for raising the security deposit ratio).<br>– In that case, though, securities companies need to provide the display of their trading screen for internet trading customers in such a way that their customers do not mistakenly think that the security deposit rates for leveraged and inverse ETFs/ETNs are being raised due to the measures for raising the security deposit ratio. |

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| | failure, accident, or other event occurs which affects both issues, this could have a significant impact on customers. Accordingly, we request TSE to reconsider/rearrange the implementation date, perhaps by delaying the implementation date until U.S. stock margin transactions are safely under way.<br>－ We request TSE to implement the revisions in such a way that we can use the method currently used for responding to issues subject to the measures for raising the security deposit ratio. If there is no difference in terms of effectiveness, we think reusing the existing method could prevent defects or other issues during the new system development. | － The implementation date will be January 10, 2023, taking into consideration the comments suggesting that (1) a sufficient period is required for making investors aware of the revisions to the security deposit rate, and that (2) financial instruments business operators need time for changing their systems and other related arrangements.<br>－ Please note that the increased security deposit rate will be applied to the calculation of withdrawable amounts for new sales and purchases via margin transactions established on or after the implementation date. |
| 5 | － 1. While it has been pointed out that leveraged and inverse ETFs/ETNs are not appropriate for long-term holding, there are also other structures/products that are not appropriate for mid- to long-term investment purposes including products tracking volatility indices and commodity products based on futures contracts. We believe these structures/products should also be subject to rules like those for requesting appropriate information provision and labeling as different from general ETFs described in "Strengthening of Regulations and Enhancement of Information Provision for Leverage/Inverse ETFs, etc.".<br>－ 2. Our group has recommended categorizing exchange traded products | － As suggested, taking into consideration that leveraged and inverse ETFs/ETNs are not suitable for long-term holding, TSE plans to revise the labels on the JPX website in such a way that it is clear that the characteristics of these products are different from those of other ETFs and ETNs. |

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| | by creation structures and using different naming based on the categories (https://www.ishares.com/us/education/etp-classification). We believe TSE should introduce measures which categorize exchange traded products in Japan not just by creation structure, but as those appropriate for mid- to long-term investment and those not, according to investment purposes. | |

Comment submitters: 1. is from Monex, Inc., 2. is from Japan Information Processing Service Co., Ltd. , 3. Is from Matsui Securities Co., Ltd., 4. is from Rakuten Securities, Inc., and 5. is from BlackRock Japan Co., Ltd.