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Financial Services Agency
Planning and Coordination Bureau Financial Markets Division
Central Government Building Number 7
Kasumigaseki 3-2-1, Chiyoda-Ku, Tokyo 100-8967

Dear Sir/Madam

Proposals for the implementation of the Financial Instruments and Exchange Act relating to High Speed Trading (“Proposals”)

FIA welcomes the opportunity to respond and provide feedback to the Proposals published by the Financial Services Agency (“FSA”) on 24 October 2017.

FIA is the leading global trade organization for the futures, options and centrally cleared derivatives markets, with offices in London, Singapore and Washington, D.C. FIA’s membership includes clearing firms, exchanges, clearinghouses, trading firms and commodities specialists from more than 48 countries as well as technology vendors, lawyers and other professionals serving the industry. FIA’s mission is to support open, transparent and competitive markets, protect and enhance the integrity of the financial system, and promote high standards of professional conduct. FIA member firms have taken a leadership role in identifying risks and strengthening safeguards in markets globally including those related to automated trading. Since April 2010, FIA has published several papers¹ proposing industry best practices and guidelines and we have submitted comprehensive responses to various regulatory proposals around the world. Further information is available at www.fia.org.

General Comments

FIA is fully supportive of the growth and development of Japan’s financial markets and supports the FSA’s regulatory objectives of ensuring markets are fair, open and transparent. A key element of encouraging the transfer of funds from savings to investment is to promote confidence in financial markets through regulation that is principles-based, fair, forward looking and encourages participation from many different types of investors and traders.

FIA believes that for any automated trading regulatory framework, risk controls are fundamental at both the market participant and exchange levels. Therefore, we commend the FSA’s proposal to ensure that participants implement certain pre-trade risk controls, as well as other measures designed to minimize the likelihood of market disruption and “abnormal” orders. We fully support the adoption of best practices regarding the development, testing, deployment, monitoring and oversight of automated trading systems. FIA has set out in its ***Guide to the Development and Operation of Automated Trading Systems***² a detailed discussion of pre-trade and other risk controls and industry best practice regarding the deployment of automated trading systems.

The role of similar controls and practices at exchange level is also key to protecting market integrity where automated trading has been adopted by many different types of market participants. We encourage the adoption of controls at exchange level that are designed to minimize the impact of any inadvertent market disruption caused by automated trading systems or human error. A detailed discussion of such controls can be found in FIA’s ***Market Access Risk Management Recommendations***.³

¹ <https://fia.org/key-issues/automated-trading>

² <https://fia.org/sites/default/files/FIA%20Guide%20to%20the%20Development%20and%20Operation%20of%20Automated%20Trading%20Systems.pdf>

³ https://fia.org/sites/default/files/content_attachments/Market_Access-Best-Practices.pdf

FIA is also fully supportive of an administrative structure for the prevention of unfair trading or market manipulation through enhanced market surveillance and supervision requirements.

Specific Comments

In addition to our general comments above, there are areas in the Proposals which FIA has concerns with or seek further guidance. Our specific comments are set out below:

1. Scope and Definition of High Speed Trading

The current proposed definition of High Speed Trading is very broad as it focuses on the technology used for accessing markets. Namely, the use of algorithms for trading, co-location or proximity with an exchange, and transmission of information that is not shared with other transmissions. This means that a wide variety of market participants (including trading firms, hedge funds, asset managers and brokers) domiciled both domestically in Japan and overseas could be captured by the new regulations. Many market participants now use a wide spectrum of automated trading strategies. There has also been a trend towards co-locating or proximity hosting these systems to increase the efficiency of their interaction with the market. In addition to the many types of participants that use co-location or proximity hosting for their automated trading strategies, there are many other brokers and independent software vendors who may also use co-location or proximity hosting of the automated trading systems they provide to their clients.

As financial markets have evolved towards greater electronification of how market participants interact with liquidity, FIA has advocated globally that the focus on regulation should be around risk controls and industry best practices for all types of automated trading. A regulatory framework should not just focus on identifying certain types of participants who should be registered and subject to a higher degree of regulatory oversight.

The use of co-location or proximity hosting as a trigger for determining whether a market participant is required to register (and comply with all subsequent requirements) may create a situation where participants will need to assess whether it is cost-effective to access Japanese financial markets in this manner. Some may relocate or exit the market completely. Other participants may choose to remain. Instead of promoting fair access to Japanese financial markets, the proposal may create an asymmetry between a few co-located firms and everyone else. Regulatory objectives can be met in other meaningful ways, for example, ensuring strong and robust risk controls are implemented to minimize any market disruptions.

If there is a broad application of the registration requirement as proposed, many market participants will incur significant compliance burdens and costs. We are concerned that these costs could have unintended consequences to the marketplace (including the loss of liquidity) that would outweigh any regulatory benefits. Accordingly, the costs of these regulations, including the registration process, should be mitigated as much as possible through a flexible, principles-based approach rather than a one-size fits all approach.

We expect many of the market participants that will be identified as undertaking high speed trading operate within a broader corporate group where the legal entity executing the transactions may not be the 'booking' entity for the transactions. As you may be aware, the 'booking' entity for a particular transaction is the legal entity which has the primary obligation for delivery or payment with respect to a financial product and is the counterparty to the transaction. Some market participants may also have more than one legal entity accessing the Japanese markets. Trading activity may be conducted by staff located and employed in different locations by different legal entities which are supported by compliance, risk, technology staff employed by affiliate group entities.

- (a) We respectfully request the FSA to be flexible and discuss with applicant firms on a case-by-case basis their applications so that firms can minimize the need for multiple registrations within a corporate group (especially as much of the information about the systems, policies and procedures and controls will be common across corporate group entities). The costs of requiring multiple, duplicative registrations would be significant with little to no perceived regulatory benefit.

- (b) We understand that a legal entity will need to register if it meets the relevant criteria including who makes the investment or trading decisions relating to high speed trading. Can the FSA provide further guidance on what factors are considered when determining who exercises this control?

2. Designation of Markets

We understand the FSA will be designating the following markets for transmission of high speed trading (“HST”) data - Tokyo Stock Exchange, Osaka Exchange, Nagoya Stock Exchange, Fukuoka Stock Exchange, Sapporo Securities Exchange, SBI Japan Next and ChiX Japan.

- (a) Can the FSA confirm that the Proposals are intended to apply to all products listed on the above markets or are there exceptions?
- (b) Can the FSA clarify what the process will be if other exchanges are to be designated in the future – is there specific criteria to be met for such designation and will any such designation be subject to public consultation?

3. Language Requirements

We greatly appreciate and thank the FSA for allowing English for the registration application form and attachments if applicants do not have an address in Japan.

- (a) Can the FSA confirm that all application documents and attachments including the Business Description/Method Manual and resumes can be submitted in English?
- (b) Can the FSA confirm that once registered, such overseas applicants can make all subsequent notifications and updates to the FSA in English or advise if there are specific circumstances a Japanese translation is required?

4. Privacy Concerns

- (a) **Application:** We understand pages 2-8 of the application form (Form 29) is to be made available in a public registry. We respectfully request the FSA to reconsider making all of this information publicly available and keep the following data private:
- Capital of the applicant - this is commercially sensitive information particularly for private companies and should not be publicly available especially for those firms who do not hold customer funds.
 - All information on other businesses of the registrant - this is commercially sensitive information that should not be publicly available.
- (b) **Annual Report:** Could the FSA also confirm that Form 30 and the annual reports will not be made publicly available? These documents contain commercially sensitive information such as volume of transactions, details of trading strategies, trading hours as well as all information on other businesses of the registrant.
- (c) **Other Privacy and Intellectual Property Concerns:** Further to (a) and (b) above, we respectfully request the FSA to not make public the other required materials for registration (*i.e.*, written oath, Business Description/Method Manual, business execution system, executive and person-in-charge resumes, financial statements including capital, net assets and profits & loss. As financial firms, our members can be subject to daily cybersecurity attacks and scams, including ones where fraudsters impersonate firm employees to steal funds. For example, in our experience, when an employee name is made public, cyberattacks have increased as fraudsters try multiple name-email combinations in phishing attacks. Accordingly, our members are very sensitive to having personal (including signatures) or business

information made public. In addition, the Associations have intellectual property concerns if information about trading strategies, profit & loss (P&L) and other sensitive information fall into the wrong hands. Traders using automated strategies spend significant time and money on the development and testing of these trading strategies and if this information is misappropriated, it could cause irreparable harm to investors, shareholders and businesses.

5. Registration Materials

- (a) Description of trading strategy:** As part of the Business Description/Method Manual, we understand the FSA requires a description of trading strategy based on the following four categories - Market Making, Arbitrage, Directional and Other.

We understand the FSA will allow a broad description of these strategies. We recommend that applicants provide the following to comply with this requirement:

- List of type of trading strategy employed by the firm (i.e. market-making strategy, arbitrage strategy, directional strategy, or other)
- Name of the related exchange(s) for each strategy type
- Name of the broker/dealer executing HST order for each strategy type
- Type of securities or derivatives which are target of HST

We respectfully request the FSA to allow applicant firms to adopt such approach when describing its trading strategies as the FSA will still receive meaningful information. We believe much of this information can also be collected from the exchanges or licensed intermediaries (e.g. brokers) especially when order flagging/categorization is introduced. Therefore, requesting more than this general information from applicants will be duplicative and will be very time consuming for applicant firms to compile. For these reasons we recommend the FSA only seek a narrower range of information. Any further detailed information and reporting information will be available from other sources such as the exchanges or licensed intermediary brokers based on actual trading activity.

- (b) Resume/Curriculum Vitae (CV):** We understand the Resume/CV of relevant directors, responsible officers and the local agent is required for applicants. Can the FSA confirm the level of detail required and whether simply including the past 10 years of employment history would be sufficient to comply with this requirement? We also invite the FSA to consider providing a template in the application form so that information can be standardized across applicants.
- (c) Certificates or equivalent documents of directors and executive officers:** We understand the FSA will require several certificates including residency certificates, certificates of solvency and confirmation that the director/executive officer is not subject to any penal sanction. We are concerned that these types of certificates do not exist in all jurisdictions. Accordingly, we recommend the FSA provide a template or specific form that would allow the individual to make a statutory declaration or oath to comply with this requirement.
- (d) Policies and Procedures:** We understand that copies of internal policies and procedures are required as part of the registration application. We have privacy concerns and we would not want these documents to be publicly available. We respectfully suggest that copies be provided upon request and be kept private by the FSA. Alternatively, the registered firm could provide these documents to the representative agent who could make them available for inspection by the FSA upon request.

6. Financial information

Financial information is extremely sensitive and confidential to market participants (particularly those entities which are private companies).

Therefore, we respectfully request that P&L information is not required to be submitted and that that financial statements relating to capital, net assets and declarations of solvency should be sufficient to meeting any financial adequacy requirements. If the FSA still requires P&L information we request that detailed expense items such as salary and other expenses not be broken down but that firms are able to provide a broad line item of expenses.

We also wish to confirm:

- (a) that any financial information provided to the FSA will remain confidential and will not be available to the public.
- (b) whether updated financial information is required on an ongoing monthly basis, as part of the annual report or only required once as part of the registration application process?
- (c) that financial statements prepared in accordance with home jurisdiction accounting standards is acceptable and that statements prepared under Japanese accounting standards are not required.
- (d) that providing unaudited financial statements are sufficient.
- (e) that financial statements will only be limited to the applicant entity (and does not include affiliated entities).

Whilst we fully appreciate that minimum financial adequacy requirements need to be met, we respectfully request the FSA to provide flexibility given the many different possible types of market participants and organizational structures that may be subject to the HST registration requirements.

7. Record Keeping Requirements

- (a) We respectfully request the FSA to amend the record keeping requirements for all records to 7 years. Under the Proposals, order tickets are to be retained for 7 years however other records such as transaction blotters and ledgers are to be retained for 10 years.

Adopting the same retention period for all records will ease compliance for market participants and align the FSA's requirements with those in other jurisdictions. Record keeping requirements in other jurisdictions are generally only up to 7 years. As an example, record keeping obligations in other parts of the Asia-Pacific region are 7 years and investment managers registered with the U.S. Securities and Exchange Commission are only required to maintain records for 5 years.

Having a much longer record retention period will be burdensome (from a cost, infrastructure and resourcing perspective) for firms and it will be particularly burdensome for those firms who trade in multiple markets around the world. Due to the common infrastructure in place within many large corporate groups, these firms would need to amend their systems and maintain all trading records (regardless of location) for 10 years if the 10-year requirement remains. We believe imposing a 7-year record keeping requirement for all records will still enable the FSA to meet its regulatory objectives.

- (b) Can the FSA confirm that records can be retained in English and are not required to be translated into Japanese?
- (c) Can the FSA explain what is intended by a 'program' which can be inspected in relation to records and ledgers?

8. Ongoing notification and filing requirements

- (a) **Annual Report:** We respectfully request the FSA to consider allowing a longer period to submit annual reports. The current proposed period of 3 months is shorter compared to other jurisdictions. For example,

in Singapore, licensees have 5 months and in Hong Kong licensees have 4 months. The additional time will give affected participants sufficient time to prepare annual reports and minimize the number of time extensions that will need to be applied for and processed by the FSA. We note that a longer period for reporting is available if it is jurisdictional practice in the home jurisdiction of the registered entity. However, some entities may not have specific reporting obligations in their home jurisdiction to rely on this exception. Therefore, we believe allowing a longer period would be appropriate.

In addition, we suggest excluding all statistical information, including number of staff, number of trades on-market, number of trades off-market etc. from the annual report. Much of this information is available from other sources and will be very burdensome for market participants to compile. Instead, we respectfully suggest that the annual report form mirror the registration application Form 29 (with the modifications we've suggested) which will facilitate the updating of any information that has changed since the last submission.

- (b) Business Description Changes:** As noted above in 5(a), we believe it would be impractical and highly burdensome for firms to set out and describe each individual trading strategy and then to notify any subsequent changes to the FSA. Individual trading strategies can be numerous, complex and change frequently which would require constant notifications to the FSA.

Can the FSA only require firms to provide updates to trading strategy information (adds, changes and deletes) during the annual report process? Otherwise, the significant compliance burdens would outweigh any regulatory benefits.

- 9. Commencing and ceasing HST:** Can the FSA provide further detail on when this notification is to be made? Further, does this relate to the trading of new products, commencing of trading on a new market or when a firm initially starts HST trading? To minimize unnecessary administrative burdens, we recommend that this notification should only be made when a firm first applies for registration and then again when they conclude all HST activity. We understand registered firms will be providing specific information updates to the FSA as part of the annual report process.

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Thank you for the opportunity to share our views.

We fully support the growth and development of Japan's markets and the FSA's regulatory objective of ensuring markets are fair, open and transparent. We would appreciate the opportunity to continue to work with the FSA and welcome the opportunity to discuss these issues in further detail with you.

If you have any questions, please contact Phuong Trinh at ptrinh@fia.org or +65 6549 7335.

Yours faithfully



Bill Herder
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