FSA Institute

International Conference on
The Future of Asian Markets and Exchanges
Summary of the Conference

The Financial Services Agency, Japan (JFSA) and the Japan Exchange Group, Inc. (JPX) jointly hosted the international conference "The Future of Asian Markets and Exchanges" on November 26, 2013 in Tokyo. The speakers, chair, and commentators were from Australia, Hong Kong, Japan, Thailand, and the United States.

To start the conference, **Ryutaro Hatanaka, the Commissioner of the JFSA**, gave the opening remarks to welcome participants and noted that the theme of the conference was very apt considering the current global financial developments. Then, **Atsushi Saito, Director & Representative Executive Officer, Group CEO, Japan Exchange Group, Inc.**, delivered the keynote speech emphasizing the importance of greater fund flows in Asia and the roles to be fulfilled by exchanges in the region.

Then, the conference moved on to two sessions. In both session 1 and 2, **Naoyuki Yoshino, Director of FSA Institute, and Professor of Economics, Keio University**, served as the chair.

Session 1: Challenges for Asian Exchanges

Session 1 examined challenges for Asian exchanges, with senior officials from exchanges speaking on the specific challenges they face and their strategies for further growth.

Charles Xiaojia Li, Chief Executive, Hong Kong Exchanges and Clearing Limited, explained HKEx's developments over the decades and then presented its strategy to become a leading exchange. HKEx's growth has been driven by China's economic growth; today 55–60 percent of its market capitalization and approximately 70 percent of its daily turnover involve firms related to China. As the economic growth of China has been slowing recently, the challenges for HKEx are to meet China's need to invest and appreciate its accumulated capital, and also to manage its risks and exposures. HKEx will make efforts to expand its asset classes and improve its infrastructure, and with its strong focus on China, it will strive to be both the exchange for the world's investment in China and the exchange for China's investment in international markets.

Pakorn Peetathawatchai, Executive Vice President, The Stock Exchange of Thailand, briefly explained the current status of the Thai financial market and described its initiatives for ASEAN capital market integration. Thai's market capitalization is increasing sharply and transaction volume is also surging, but its size is still not comparable to the markets of Tokyo, Singapore or Hong Kong. In order for the Stock Exchange of Thailand to grow further, the integration of ASEAN exchanges (7 exchanges in 6 countries) is one of the key initiatives, providing easy access to an expanded asset class with market capitalization of approximately 2 trillion USD to investors. In addition, the Stock Exchange of Thailand will try to collaborate for growth with emerging economies in the region, for example Myanmar, Laos, Cambodia and Vietnam, by promoting investment in these countries through education and information sharing. As there will be a need for infrastructure investment in Asia, the Stock Exchange of Thailand will also provide a variety of new investment vehicles, such as infrastructure funds and holding company listings, to support infrastructure development in the region.

Shin-ichi Fukuda, Professor of Economics, University of Tokyo, explained why Asian countries need to develop local exchange markets. Lessons from the Asian financial crisis in 1997 are behind the Asian countries efforts to develop exchange markets. Although Asia's financial systems have improved substantially following the crisis, Asia's high savings are still not invested in Asia directly due to underdeveloped financial markets, and therefore vulnerability stemming from mismatches in international capital flow remains. Further, while Asian countries are achieving high economic growth, investment ratios have remained low in many of them since around 2000. It is therefore important to foster Asian stock exchanges that will contribute to sustainable economic growth in the region. Development of more efficient capital markets will lead to economic stability through the utilization and circulation of huge savings in Asia.

Bob Takai, President & CEO, Sumitomo Shoji Research Institute, Inc., explained challenges for Asian exchanges in terms of commodities markets. Asia is the largest consumer of a wide range of commodities, and therefore commodities are important for Asia's growth. However, there are very few active commodity exchanges in the region.

The pricing of commodity contracts are mostly made in London, Chicago, and New York. Asia needs to have its own active commodity exchanges in its time zone. Therefore, HKEx's purchase of London Mercantile Exchange (LME) was a very effective and strategic step that would enable HKEx to explore the growth potential of Asia. For LME, there are still the issues of how to compete and coordinate with the mainland's exchanges, and how to expand its coverage to other commodities such as energy. He emphasized the need for Japan to have a "vertically-integrated multi-asset class exchange." Japan should consolidate commodities exchanges into a JPX platform so as to concentrate its managerial and technological resources in order to compete with other Asian exchanges.

<u>Discussion</u>

After the presentations, Prof. Yoshino asked speakers and commentators some questions. First, Prof. Yoshino asked Dr. Li how HKEx was going to incorporate LME. Dr. Li said its strategies were to extend LME into Asia, such as by introducing a benchmark price and Asian time zone clearing, and also to compete and cooperate with the mainland exchanges. Prof. Yoshino then asked Mr. Bob Takai who should be focused on in the commodities market. Mr. Takai commented that one of the reasons why the futures commodities market failed in Japan in the past was because the market focused too much on retailers, who did not fully understand the volatility and structure of the market; therefore, in order to enhance the investor basis for the commodities market in Asia, we need to foster professional, institutional investors.

Finally, Prof. Yoshino asked Dr. Li and Mr. Peetathawatchai how they see the Tokyo market. Mr. Peetathawatchai said that there are many common interests between JPX and SET. One is to support the development of exchanges and financial markets in emerging economies. In addition, there would be a great benefit for the region in cross-listing Asian assets, so the Stock Exchange of Thailand would like to cooperate with JPX to this end. Dr. Li made interesting observations about global exchanges. He said that there are two categories of exchanges: one group is Tokyo, China and NY, and the other HK, Singapore and London. The first group of exchanges consists of those that have huge domestic markets, which were their primary drivers of growth. In some way, due to powerful domestic markets, Tokyo and China might have been victims of success in the domestic market; they are domestic-oriented despite their potential to become much more important outside their core markets. The latter have no strong domestic markets, and thus they had to constantly reinvent their functions. As a result, HK has grown by becoming the main gateway for China, Singapore by serving as the gateway to South East Asian financial markets, and London by acting as the off-shore dollar center.

Session 2: The Role of Tokyo Market in Asia

Session 2 focused on the Tokyo market, discussing its strengths as well as weaknesses through international comparison, and also identifying its challenges in becoming a further leading market.

Michael Aitken, Professor of Finance, University of New South Wales, demonstrated an international comparison of the quality of the Tokyo market using his newly-developed software called the "Market Quality (MQ) Dashboard," which estimates the impact of market design changes on efficiency and fairness of markets. He compared Tokyo, Hong Kong, London and New York markets in terms of efficiency, which were measured based on effective spreads. Tokyo was as efficient as any market in the region, but slightly behind London or New York. In terms of fairness, Tokyo was a very fair market compared to other markets based on the metrics for insider trading and market manipulation. He also compared the volatility of these markets. Interestingly, the software showed that the volatility of Tokyo was higher compared to other markets, increasing since January 2013.

Jun Uno, Professor of Finance, Waseda University, examined the competitiveness of stock markets and exchanges. He raised some of the factors that affect the functions and effectiveness of stock markets, such as trading rules, international cross listings, turnover and liquidity, and provision of new products. He conducted an assessment based on these factors for Hong Kong, Singapore, Australia, and Tokyo. Each market had its strength, where Hong Kong had a large trading volume in ETF, Singapore exceeded other exchanges in terms of cross listings, and Australia had a very liquid market. Tokyo led others in turnover and global investment. With regard to the development of an ETF market, Asian exchanges are behind other global exchanges and therefore the creation of new investment opportunities for Asian investors is a greater challenge for these exchanges. Asian exchanges should also cooperate to avoid market segmentation in order to maximize market liquidity. He explained this by referring to gold ETFs, which are traded in Hong Kong, Singapore, and Tokyo, pointing out that because they are quoted in different currencies, the market for the products is segmented and market liquidity cannot be maximized.

Saskia Sassen, Professor of Sociology and Co-Chair of Committee on Global Thought, Columbia University, described two factors that are shaping today's global financial system. First, unlike what is commonly asserted, it is the specialized differences of each city and its financial center that are becoming increasingly important in our global era. Globalization does not homogenize everything. Second, as a result of the importance of specialized differences, there is less competition among cities and their financial centers than is commonly assumed. That specialized differentiation also feeds a more networked format for the global financial center: no international exchange can thrive if there are no other exchanges. In an earlier epoch there was enormous redundancy in the international system: every major national financial center duplicated many of the basic functions. Logically speaking one might argue that given the globalization of economies we could have just a very few "super" exchanges in the world. This is not, however, what has happened. The complexity of the financial system and the sharp expansion of the capacity to financialize more and more components of economies (buildings, mortgages, commodities, etc.) have led to a multi-sited global financial system with about 20 major exchanges, each quite specialized in some sectors. A somewhat unexpected element feeding this multi-sited global network that has emerged over the last 20 years is that the histories and competencies of cities and their financial centers have become more and more important. Hong Kong has a history and knowledge different from Shanghai's, and Tokyo's is different from London's. The result is a trend that goes in the opposite direction of the post-World War II decades, when the expansion of finance meant that each financial center expanded its capacity to incorporate general financial functions. Today, it is the capacity to provide differentiated and complex knowledge that matters, and this is partly fed by the particular economic histories and experiences of each of the twenty major and the other 40 minor global cities. This network is a sort of global multi-sited infrastructure for economic globalization. It is one key factor as to why one "super" exchange has not emerged, and is not about to. We have a global, multi-sited and differentiated system.

Jonathan B. Kindred, President & CEO, Morgan Stanley MUFG Securities Co., Ltd. discussed strengths and challenges for Japanese capital markets from the standpoint of a foreign participant. As its strength, he raised Japan's wealth due to its large economy, a deep, efficient and liquid equity market, liquid derivative and currency markets, and advanced technology for trading. Further, strong macro-economic policies (Abenomics) are being employed and are having positive effects on the markets.

With regard to challenges, he raised the following points. First, domestic investors should engage more in equity trading. This is because, while domestic investors exceed foreign investors in terms of equity ownership, foreigners surpass in terms of trading. Second, Japan's savings are underutilized, both for individuals and institutional investors (pension assets). Third, the very high government borrowing that must be addressed in the long term to increase the attractiveness of the market. The large government debt market could be crowding out corporate bond and CD markets.

Sam Y. Kim, Managing Director, Head of Trading & Liquidity Strategies Group, Asia Pacific, BlackRock, discussed the role of the Tokyo market in Asia, by first looking at how the market has changed in the past year and then comparing such factors as liquidity and efficiency with other Asian markets. In the past year, both professional and retail investor positioning have changed to reflect the net buying of Japanese equities while such positioning in the emerging markets, including Asia, has moved in the opposite direction. Using multi-asset concentration indices, he showed the difference in the market environment between Tokyo and the rest of Asia. For 2013, the risk-taking incentive in Tokyo increased following the introduction of Abenomics in November 2012. Since then, Japan has been the key driver of regional investment performance. At the same time, it should be noted that the market conditions influencing an investor's ability to take risks is very different in Japan from the rest of Asia. Factors such as deep and active liquidity, the breadth of investable stocks, and efficient transaction costs have facilitated risk-taking in Japan. Rule changes in trading also have had positive effects. Regarding challenges for Tokyo, it would be ideal to have a forum between regulators, exchange partners and fiduciaries to discuss regulations and market conduct to improve market structure, given that some market practices conducted in other markets are not utilized in Tokyo.

Toshihide Endo, Deputy Director-General, Planning and Coordination Bureau, JFSA, discussed three challenges for further development of the Tokyo market. They were challenges related to JPX, the government, and the city of Tokyo. A challenge related to JPX was the need for initiatives to create a comprehensive exchange, with derivatives and commodities on the same trading platform. The government's challenges in achieving sustainable economic growth are to promote the supply of funds from households to growth areas, and to promote portfolio rebalancing of public funds. Further, measures encouraging companies' reforms and venture capital are also important. The government would also provide technical assistance to Asian countries for financial regulation and supervision to support their efforts to strengthen financial systems. Tokyo's challenges are its efforts to become a "global city" that has high quality office buildings and efficient transportation systems, and also a city that is ecological and disaster tolerant. Japan will keep up its efforts to make the Tokyo market and its city business friendly and attractive.

Discussion

After the presentations, Prof. Yoshino asked speakers and commentators some questions. First, Prof. Yoshino asked Dr. Aitken about possible proposals for the Tokyo market to improve its fairness, efficiency and market confidence. Dr. Aitken commented that each market should learn from changes made by other markets by gathering data. He also said that Tokyo is a very efficient market in terms of trading cost. With regard to high frequency trading (HFT), Dr. Aitken said that 19 studies out of 20 suggested that HFT is good for markets. Mr. Uno remarked that the strength of the Tokyo market is active trading so transaction costs must be kept low. Further, HFT is important for maintaining market liquidity. Mr. Kim also commented that Tokyo is the cheapest place to trade in Asia. Mr. Kindred emphasized that Japanese households' assets are concentrated in deposits, and this should be changed. A tax policy could be one way to change this. The introduction of the NISA program is good, but the cap could be doubled to JPY 200 million.