

The results of "Survey regarding 10-year JGB Futures Trading"

[Status of Responses]

Total Responses: 55

(Trading Participants: 46 Non-trading Participants: 9)

1. Your company's trading activities for 10-Year JGB Futures

Q1. Did your company's trading volume of 10-Year JGB Futures increase or decrease in the latter half of 2008 (*1), compared to the latter half of 2007 (*2)?

(Please circle your answer and describe to what degree.)

*1 from July 2008 to December 2008

*2 from July 2007 to December 2007

Q2. If you answered "Increasing" or "Decreasing" for "Q1", please explain the reasons for such a trend.

The vast majority of the responses (39 responses) to this question regarding trading-volume of 10-year JGB Futures indicated a decrease, while the remaining (9 responses) indicated an increase.

Major reasons for the decrease in trading volume were identified as "a decrease in futures-trading market participants" (15 responses), "futures trading not being an effective hedging-tool due to a decline in the price correlation between cash-markets and futures trading" (9 responses), "a rise in volatility due to a decline in futures trading liquidity" (7 responses). The remaining reasons are listed below.

- A change from futures day-trading to options trading.
- The low usability of the current derivative system/trading terminals.
- A reduction in the long-term JGB cash market, swap market, etc.

Q3. Will your company's trading volume of 10-Year JGB Futures increase or decrease in the near the future, compared to the latter half of 2008(*)? And to what degree?

(Please circle your answer, and describe to what degree as best you can)

* from July 2008 to December 2008

Q4. If you answered "Increase" or "Decrease" for "Q3", please describe the reason for it as best you can.

While there were some responses indicating an expected increased (12 responses) or expected decrease (9 responses), the bulk of responses (30 responses) indicated they expected to maintain the current level of volume.

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The reasons for an expected fluctuation in trading volume were primarily comprised of the following.

(From those who indicated an expected increase in trading volume)

- Though the severe condition of the macro-economic environment is expected to continue, the worst period has passed, and a slight return of participants is expected.
- The flow of customers will improve as financial markets settle down.
- The price correlation between JGB cash-market and futures trading will recover as market conditions continue to settle down.
- If the trading volume and liquidity of the market as a whole returns, our futures trading volume will also increase accordingly.

(From those who indicated an expected decrease in trading volume)

- Fear of a decline in hedging effectiveness due to a decline in the price correlation between cash-market and futures trading.
- Retreat of interest-raising risk (hedge needs) due to economic recession.

(From those who indicated expectations of stable volume)

- There is no pessimistic expectation for further decreases, because only investors who trade while watching relative values have decreased. There has been no significant change in other participants.
- There is the possibility that trading volume will increase or decrease, depending on market movements.

2. Reasons for the 10-Year JGB Futures market recession and measures for improving the market

Q1. Please explain your thoughts on the cause of the recent decrease in trading volume and open interest in the 10-Year JGB Futures market.

Q2. Some point out that the price correlation between the 10-Year JGB Futures market and other interest-related financial markets (i.e. 10-Year JGB cash market) has been decreasing. What do you think the reason for such a decrease is?

A large portion of responses indicated mutually related factors responsible for the decrease in trading volume and open interest in the 10-year JGB Futures market. “A reduction/withdrawal of foreign investors” (28 responses), “A decline in the hedging functionality of futures as well as a shift to hedges in

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cash-markets due to decreased price correlation with the cash-markets” (15 responses), “Excessive volatility due to reduced futures liquidity, and the reduction of outright trading” (13 responses), “Decline in participant’s toleration of risk due to credit crunches” (8 responses) comprised the majority of responses. Remaining reasons are as follows.

- Low usability of the current TSE terminals (4 responses)
- Reduction in trading on the bond markets as a whole.
- Decline in the hedging needs.
- There was no push for policies facilitating domestic market participants which have extremely high proportion of JGB possession. The issuance/balance structure and difference of liquidity, etc. of Japanese government bonds according to the category of maturity at the time of issuance was not considered.

For the most part, responses related to price-correlation with other markets indicated relations to liquidity as above, but more detailed responses were received as follows:

- A period of concentration on outright trading on futures caused a strain on the yield curve (futures relatively high valuation), and arbitrage positions related to that strain were caught up in loss cuts. Such circumstances caused the relatively high valuation of futures to be magnified.
- With a rise in fundraising costs due to worldwide credit crunches, futures, etc. were preferred to cash-products, but with an absence of arbitrage trading investors, this resulted in continued high volatility limited to futures.
- Avoidance of credit risk spurred from the subprime-shock aroused demands for JGB futures purchases as a substitute for cash trading and SWAP. Due to a long-term continuation of the relatively high valuation of JGB futures, there was a breakdown in arbitrage trading of cash trading and SWAP. It is felt that the reduction in arbitrage trading participants caused spiraling decline in price correlations.

Additional opinions received are listed below.

- Because the coupon rate widely deviates from current interest rate, the cheapest-to-deliver bond is fixed to 7-year maturity. Consequently, there is only price correlation for the 7-year point. (4 responses)
- While trading is limited to 10-year JGB Futures, investors use them as a means of hedging for a variety of products. As a result, it is easy for market movements to become irregular.
- For foreign and domestic investors, trader positions become too same-sided, thus making positions hard to be offset. This probably influences the decline of correlation.
- The volume of traders who primarily trade off-balance has become relatively high, the frequency of the use of futures by domestic market users as a hedging tool is decreasing. There is insufficient action promoting the use of EFP.

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Furthermore, other opinions regarding appraisal of the level of price correlation were: “The correlation is thought of as decreasing that much” (2 responses), “It was bad before now, and with the decrease in liquidity, it has become worse.”

Q3. What is your evaluation of the trading rules and framework for 10-Year JGB Futures?

For this question, 35 participants responded that they were “Mostly satisfied”, and 12 responses indicated participants were “Have a request(s) for improvement”. Furthermore, within those who responded “Mostly satisfied”, 4 responses went on to say “No change is needed in the present contract specifications.”

The opinions of those who responded “hoping for improvement,” are as written below.

- From the perspective of raising price correlation with the 10-year zone, reduce 6% of the standardized coupon rate. (5 responses)
- Bring remaining maturity of deliverable grades closer to 10-years (8.5-years, 9 years, etc.). By doing this, plan the improvement of price correlation with 10-year zone interest and the revitalization of 5-year JGB futures. (2 responses)
- Expand the standardized maturity to 2-years, 20-years, etc. like the US.
- Extend futures trading hours, or allow for 24-hour trading in order to increase trading opportunities, and reduce the price gap arising from reflecting overseas market movements. (3 responses)
- Broadened price limits through the circuit-breaker system are amplifying instability of the JGB Futures market beyond what is required. This is one source of decreased participants, and should be returned to the original price limit (2 yen).
- The Itayose method needs to be examined for cases where trading is one-sided,
- Rules and regulations supporting balance between speculators and those with other intentions should be re-considered. (Counter-measures against anti-competitive futures trading by specific investors, correction of liquidity disparities between futures and the cheapest-to-deliver)
- Reform the fee structure for futures trading.

Furthermore, summaries of comments on the aforementioned opinion that “no change is needed in the present marketability” were as listed below.

- The cheapest-to-deliver falling in the 7-year zone is thought to be one of the causes of last year’s market disruption. Along with the settling of the market, relatively high valuation of futures on the yield curve has been reduced and there is general satisfaction. There is no particular need for a change in the contract specifications at the present time.
- Because it is feared that coupon-change, etc. for the improvement of liquidity and correlation with

Reference Translation

the cash bond market will have the opposite effect of decreasing participants, it is hoped that this action be avoided.

*Responses to other questions related to trading regulations for current 10-year JGB futures trading were included in this section.

Q4. What is your evaluation of the convenience and user-friendliness of items outside the trading rules and framework (e.g. the trading system) for 10-Year JGB Futures?

For this question, 26 participants responded with “Mostly satisfied”, and 27 indicated they “Have a request(s) for improvement”. Some concrete requests for improvement are listed below.

(1) Requests for improvement of the current derivatives trading terminals offered by TSE.

- Increase the number of order book screens that can be displayed (3 responses)
- Improve the method of inputting orders (4 responses)
- Improvement of usability, such as having to set issue-browsing daily, etc. (2 responses)
- Improvement of the soft limit functions for placing orders
- Addition of trading position management functions. (2 responses)
- Addition of a function of displaying the opening, closing, high, and low prices on the day of trade, excluding prices in the evening trading session on the previous day.

(2) Requests for improvement of the current derivatives trading system (terminal excluded)

- Addition of order bundle cancellation functions.
- Increase the number of quotes (currently +/-5 ticks) on the ISV terminal price data. (2 responses)
- Shorten the time between updates to order book information. (2 responses)
- Improve data processing speed.
- Slow down processing speed, because trading is becoming difficult due to enhancements to system speed. (2 responses)
- Order book information should be disclosed to parties other than trading participants.
- Development of weekday trading-hours test environments.

(3) Requests regarding Tdex+ system

- With announcement of the introduction of the new option system occurring not long after the launch of the current derivatives trading system (January, 2008), the current situation is that there is a large monetary and personnel burden involved in handling rules & regulation and system changes for both launches. It is understood that the new system and trading rules & regulations are planned to improve user-friendliness, so it is hoped that the opinions of the trading participants will be adequately considered. It is also requested that the above reasons

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be thoroughly considered as reasons for a decline in trading. (3 other responses expressed the same opinion)

- The move to the new trading system for options trading on JGB futures is planned for July of this year, but it is requested that the current futures trading system be continued for at least 5 years.
- It is requested a singular system for futures and options be created as soon as practicably possible.
- It is requested the next-generation system and trading rules & regulations be quickly settled upon for JGB-futures trading, and that transparency on their future development be ensured. While the future system remains undecided, transitioning only to a new options system leaves important information lacking with regards to planning and proceedings for installation and the company infrastructure of trading participants.

(4) Others

- Avoidance of the incessant system troubles which occurred in 2008.
- Functions on the electronic trading market are insufficient. There should be annual improvements made, not just once every 5-10 years.

*System-related responses to other questions were included in this section.

Q5. The state of 10-Year JGB Futures trading is closely related to the cash bond market and other financial markets. If you have any request(s) for improvements that the TSE should make in collaboration with other related institutions, please describe such request(s).

Responses to this question are as written below.

- It is hoped that securing liquidity of the repo market (especially of the cheapest-to-deliver) will be examined. (2 responses)
- It is hoped that a coalition will be formed with LIFFE and positions will be transfer between the TSE and LIFFE. (2 responses)
- The monetary and personnel cost of changing to the new systems is too a large burden on participants. It is hoped that cooperation with other related institutions should be achieved in order to establish a common-platform.

3. Others

If you have any other requests, opinions, etc, about the TSE's operation and maintenance of the market, please describe them below.

The following response was received regarding this question.

- The website is not user-friendly. It is not clear what has been updated. Sometimes the TSE's

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updated information is obtained through information exchange among participants, but it is hoped that information regarding improvement and amendment of market operations and system-related matters will be made available as needed.

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