Japan Securities Dealers Association
JSDA

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Mr. Werner Bijkerk,
International Organization of Securities Commissions
C/ Oquendo 12
28006 Madrid
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Dear Mr. Bijkerk,

Re: Public Comment on Consultation Report: Regulatory Issues Raised by the Impact of Technological Changes on Market Integrity and Efficiency

The Japan Securities Dealers Association (JSDA) welcomes the opportunity to comment on the consultation paper, "Regulatory Issues Raised by the Impact of Technological Changes on Market Integrity and Efficiency."

Market participants have significantly benefited from expansion in the use of innovative technologies in various aspects. At the same time, recent events in markets that were powered by cutting-edge technologies underscore how critical it is for regulators to carefully watch the advancement of technology and consider its implications on market infrastructure. We believe that now is an opportune time to review a number of market issues derived from technological changes with a view to further enhancing the stability of the market. We have the following comments from our experts, which focus on Questions 3 and 4 raised in the consultation paper.

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High Frequency Trading (HFT) is one of the key developments stemming from recent technological advances. While the HFT might have some positive impacts on the efficiency of the price discovery mechanism, there have increasingly been arguments over the risks posed by HFT to the resiliency and stability of markets, as described in the consultation paper. In order to mitigate such risks, the possibility of introducing the real time or pre-trade screening of orders might be examined.

However, it is not easy to define HFT and identify orders based on HFT. Furthermore, it also seems difficult to process the massive amount of data and instantaneously identify orders that may lead to market glitches. Even if it were possible, the costs for developing such a monitoring system would be huge and far exceed its benefits. It should also be noted that such a pre-trade monitoring system, as well as the registration requirement for HFT firms, might drain the market's vitality and shrink activity. Therefore, we believe that, to prevent the recurrence of market events like the Flash Crash of May 6, 2010, it is more practical and effective to design and implement effective trading control mechanisms, such as circuit breakers, limit-up/down and other mechanisms as being implemented at Tokyo Stock Exchange (TSE).

The TSE has employed the following trading control mechanisms which have successfully functioned to avert devastating market price fluctuation, that could be further accelerated by HFT or algorithmic trading. First, the TSE has adopted a daily price limit, as a basic trading control mechanism, which limits the maximum range of fluctuation within a single trading day.

Furthermore, the TSE employs a unique trading mechanism called the special quote mechanism. Under this system, orders can only be executed immediately within a certain range of the last executed price. If the execution is likely to occur outside this price range, execution will be halted temporarily and a special quote sign is displayed to indicate the imbalance between bids and offers, and encourage market participants to place balancing orders on the other side of the order books. If no counter orders are placed and no trades are executed at the special quote price, the special quote is renewed at three minutes intervals.

In addition, since the launch of its new trading system with high-speed processing capacity in 2010, the TSE has implemented a mechanism that supplements the special quote mechanism, called the "sequential trade quote". Under this mechanism, when sequential execution of a single buy/sell order causes the price to exceed the last execution price plus/minus twice the special quote renewal price range, a sequential trade quote will be displayed for one minute to attract other orders to counter the sharp price movement, and then the order will be matched again. If no opposing orders that are to be executed within the special quote renewal price range are placed, the sequential trade quote is replaced with a special quote.

In designing these mechanisms, regulators should also ensure that equivalent measures are taken among multiple market venues and between cash and corresponding derivative markets.

Lastly, regulation must be designed to preserve the basic functions of the market and its efficiency. Regulators should consider that it is important to strike an optimal balance between the benefits of inherent market functions and those produced by market regulation. We also believe that it is equally crucial in implementing regulation that regulators have sufficient expertise and appropriate understanding of incessant market volatility and development to make appropriate and effective use of the regulatory tools available. Such sensible implementation of regulation by capable regulators would foster confidence in market regulation among market participants.

We hope that our comments above will contribute to the IOSCO's task of further enhancing market integrity and efficiency.

Best regards,

Susumu Kohsaka

Susumu Kohsaka
(Executive Chief of Operations for International Headquarters, Japan Securities Dealers Association)