14 May 2013

Re: Tokyo Stock Exchange Inc.’s comments on Financial Benchmark consultative report

Mr. Alp Eroglu
International Organization of Securities Commissions (IOSCO)
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Spain

Dear Mr. Alp Eroglu

1. Introduction
Tokyo Stock Exchange, Inc. (TSE) highly appreciates this opportunity to submit comments on the Consultation Report on principles for financial benchmarks published by IOSCO.

Financial benchmarks play an extremely important role in the invigoration and development of the financial market. Transparency of financial benchmarks is required more than ever from the perspective of investor protection and fair market operation. TSE appreciates IOSCO’s efforts and the publication of the Consultation Report and looks forward to this becoming a means to enhance the credibility of financial benchmarks.

TSE, part of the Japan Exchange Group, Inc. (JPX), calculates and distributes various indices including TOPIX, a representative equity index of the Japanese market. As a major exchange representing Asia, TSE globally provides its market data. Utilizing this market data, especially stock price data, a variety of indices are calculated both in Japan and oversea, which reflect moves in the Japanese market. Products based on these indices of TSE markets are available for trading all over the world.

TSE submits comments to offer our insights and views on financial benchmarks based on our experience of calculating indices as an exchange and being the source of data for the calculation of indices by external entities. We hope that our comments will be of use to IOSCO in the drafting of the final report on principles.

2. General Comments
Allowing various approaches depending on the importance of the benchmark and avoiding over-regulation

With the diversity of regulatory structures and business practices in different countries, there should be an
acknowledgement of the various approaches for ensuring the appropriate benchmark determinations suited to the situation in each country. TSE concurs with the view expressed in the Consultation Report of the avoidance of a "one-size-fits-all" approach.

There is also a diversity of benchmarks tailored to meet various market needs. Some financial benchmarks are referred by heavily traded financial instruments for purposes of determining their prices, while some benchmarks may be aimed mainly at measuring performance or other forms of analysis. There are also financial benchmarks which are customized or proprietary, and used only by certain or a small number of parties. In light of the wide range of benchmarks, we believe it is appropriate to seek approaches suited to the importance and impact of each benchmark instead of pursuing a uniform standard.

Furthermore, we are concerned at the adverse impact on financial market activity from strict application of the principles. Administrators are constantly being resourceful and creative in developing indices to respond to the diverse needs for financial benchmarks. From the perspective of maintaining appeal to users of benchmarks and constructing vibrant markets, it would be desirable that consideration be given to avoid over regulation.

3. Specific Comments to 1. Equity indices in Chapter 3

Financial benchmarks calculated based on prices formed in a highly transparent market

Stock prices in the exchange are formed through automated trading systems by aggregating orders from investors based on fair trading rules. Therefore, stock prices obtained from exchanges are highly transparent and fair valuations. In general, with regard to equity indices calculated based on fair market prices from an exchange, the likelihood of conflicts of interest in the data source are considered to be extremely low whether the benchmark is calculated by the exchange itself or by an administrator other than the exchange based on the data produced at the exchange. For such benchmarks, we believe it is not appropriate to apply the same level of regulation as those based on data sources which may have conflicts of interest.

Considerations on supervisory regulation

Markets operated by exchanges such as TSE are generally regulated markets subject to regulation and supervision by the financial services authority of the jurisdiction. The provision of transaction data and the calculation of indices based on such data at TSE are also subject to the supervision of the authorities. As such, supervisory enforcement system on data sourced from and calculated by such regulated exchanges are already in place. Even though some of these indices are not fully compliant with the content of the principles sought in the Consultation Report, we believe that the quality of such indices satisfies the expectations of the market to a certain extent. In addition, Japanese stock price indices are calculated based on calculation guidelines, thereby ensuring their public nature and neutrality.
4. Comments on Specific Principles

1. Overall Responsibility for the Administrator

In calculating a stock price index, Administrator may utilize the expertise and technologies of other parties, and jointly calculate benchmarks with other parties to offer index design aimed at greater user convenience. In such cases of jointly-calculated indices, the roles and accountability in index calculation are normally specified in agreements among or between the parties involved. We hope that this practice of joint ventures will be considered with regard to the application of this principle.

In addition, with regard to index calculation, the calculation methodology normally includes exemption of Administrator’s liabilities regarding matters such as errors in index values and cessation of distribution. If such exemption of Administrator’s liabilities is not allowed, it may mean unlimited liability, which may hinder sound exchange market operations.

2. Oversight of Third Parties

The principle requires reasonable steps, such as contingency plans, to be taken to avoid undue operational risk. Descriptions of such contingency plans should be specifically defined within the principles.

There are cases where a part or the entire IT system development process for an index calculation engine is outsourced to external entities, or some calculation operations which are not important in the overall process are outsourced to external entities. It should be clarified that such outsourced entities should not fall under the third parties mentioned in the principles stated in the Consultation Report.

16. Audit

In Japan, as part of the internal control function required by the Companies Act, companies generally establish an internal audit department which carries out operational audits of each department. We think such operational audits correspond to the audit mentioned in the Consultation Report.

Annex Submission

It is unclear what cases fall under those that require data to be “submitted”.

If the data “submitter” is an entity of a highly public nature or if it is an organization subject to strict regulation (including regulated exchanges), the conflicts of interest inherent in benchmarks calculated based on data submission is considered to be extremely low. Furthermore, with regard to public organizations that are data submitters, it is not realistic to apply “13. Submitter Code of Conduct”. Therefore, even for cases of data provision based on submission from a third party, it may not be appropriate to set a uniform code of conduct with high standards if the submitter is an entity of a highly public nature.