



Photograph by Michael Ross

Regulatory news

FSA Proposes Amendment of Regulatory Structure

Topics of the month

FIA Japan Plans Tokyo Conference

PEOPLE INTERVIEW

Leo Melamed, Chairman Emeritus of CME Group

Leo Melamed and CME Have a Long Standing Partnership with Japan

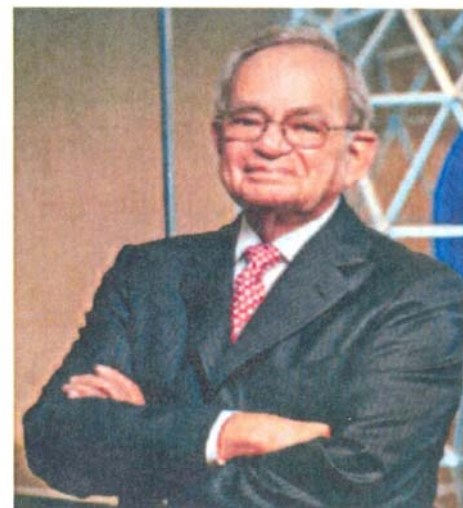


Leo Melamed and CME Have a Long Standing Partnership with Japan

Leo Melamed is Chairman Emeritus of CME Group and chairman of its Strategic Steering Committee. He is globally known as the founder of financial futures since he launched FX futures in 1972, creating the first financial futures market. Over the years, He led the CME in its expansion and diversification introducing creative new financial derivative products and helping it to become the world's largest futures exchange. Leo has a long relationship with Japan beginning as a child with his escape from Poland at the start of World War II. He and his parents obtained life-saving transit visas from Chiune Sugihara, who was then serving as Japanese Counsel General to Lithuania. They eventually landed in Kobe where he was enrolled in elementary school. His affection for Japan continued over the years as he became the leader of the CME. Under his direction he opened the CME's first Asian office in Tokyo in 1987. At that time he encouraged and assisted OSE in the development of Asia's first stock index contract which became the Nikkei futures. This is a critical time for Japan and its financial market development. We are very pleased to have Leo Melamed's comments and suggestions for our newsletter.

EB : The CME came to Japan and opened its office in Tokyo in the mid 1980's. It was the first overseas office outside of London. Why did you focus on Japan at that time?

L.M. : As you said, the CME's connection to the Japanese markets is of long standing. Our Tokyo office, opened in the mid 1980s, was our first in Asia and has been maintained throughout the years. At that time Japan's futures markets were in their embryo and we thought that by helping the Japanese community launch futures, the CME would become a partner to their growth. To a degree that occurred. We became advisors to the launch of the original Osaka 50 and later helped transform this index market into the hugely successful Nikkei 225 index contract. We made a partnership arrangement with the Nihon Keizai Shimbun and gained rights to trade the



Leo Melamed
Chairman Emeritus of the CME Group

Nikkei 225 on the Merc floor during its business day. It was a major international step for the CME and part of our long range strategy to become the stock index market for the world. The idea was hugely successful. In 1990 we launched dollar based futures and added a yen based contract in 2004.

With respect to Japan, our partnership is still strong. The Nikkei 225 is traded at the OSE, in Singapore and at the CME where it is now traded on a nearly round-the-clock basis on the Globex platform. Having 24 hour availability was made possible by working with NKS and OSE to expand our trading hours as part of our close collaboration to build and expand our markets. As I mentioned, today, there are both yen based and dollar based futures and options instruments. The original U.S. dollar-denominated futures have been listed for trading for over 20 years. Activity in these contracts has accelerated tremendously since CME Group introduced companion futures contracts denominated in Japanese yen in 2004. Prior to listing of the yen-denominated contracts, the dollar-denominated futures traded around 4,000 contracts a day. By contrast, last year found CME trading an average of over 40,000 contracts per day in these 2 products. We recognized that Market dynamics would create a spread between JPY-denominated Nikkei 225 Index futures and their USD-based brethren. As a result, list-

“The main reason Japan fell severely behind can be answered in two words: “Regulatory gridlock.”” *Leo Melamed*

ing both a yen and dollar version of these contracts allowed us to provide important tools for market participants to trade the spread. Importantly, with CME's multi-asset abilities we provide currency futures which allow clients to lock in the exchange rate when trading these spreads. All in all, our early interest in Japan was an insightful idea.

EB : In the past 20 years, the US and European financial markets exploded in terms of the growth of those financial markets and exchange traded products. In the meantime, Japan fell severely behind in its development of Tokyo as an international financial center. What happened?

L.M. : The main reason Japan fell severely behind can be answered in two words: "Regulatory gridlock." Actually there were two problems: 1) Regulatory gridlock; and 2) being in a drawn out severe recession that affected every aspect of the financial sector. This brought financial development and innovation in Japan to a near standstill.

EB : What is your recommendation for the Japan derivatives market today, particularly in light of the growing market in China, India, Singapore and Hong Kong? Is it too late for Japan?

L.M. : Today Japan and Tokyo seem to be emerging from their past difficulties. The turf war between regulators seems to be settled and a "one-stop" exchange is in the works. The merger of the TSE and the OSE will create a mega exchange to handle stocks, commodities and futures. The discussions by the FSA, the Agriculture Ministry, and the Minister of Economy, Trade and Industry has seemingly reached an agreement to allow FSA to be the single authority of the united exchange. This move of unification of regulators is to be applauded.

It seems to me that the OSE will continue to be the driver of innovation and expansion in financial market development. Indeed, the OSE managed to stay relatively strong during the past several decades when there was little expansion in financial services within Japan. The OSE, I believe, has a good history of innovation and has officials that can provide leadership that will be necessary to boost liquidity and advance market development. The consolidation of supervisory powers will be of great benefit to the financial markets in Japan.

I believe that the CME can play a strong role in helping the new unified exchange and particularly the OSE with its prospective growth plans. As previously noted, the CME has a long standing constructive relationship with OSE and is ready to offer its strength and expertise to further the existing partnerships between the two exchanges. For those reason, I am cautiously optimistic. I am also mindful that there is a good deal of unexplored potential within the Japanese commodity indus-

try which suggests that the Tocom Exchange also has good growth potential.

EB : What are some of the CME plans relative to Japan?

L.M. : Today the CME has the largest array of index futures and options instruments of any exchange in the world, covering domestic markets across the capitalization spectrum, industry sectors, Japan and India. We provide order routing facilities which allow our clients to access the Mexican and Korean markets as well. We are also working to finalize the opportunity to make the Brazilian market available on our platform.

We have plans to expand our partnership with the OSE with additional products. Currently, we are working to bring a micro version of the N225 contract on to our Globex platform which we believe will lead to more retail market participation in the N225. We use the term "micro" to reflect a smaller contract multiplier. Today, we offer the \$5 multiplier and we will be bringing a \$1 multiple to the market, meaning that the contract will be 1/5th the size of our existing product. As we do that, OSE will launch a contract based upon the Dow Jones Industrial Average to provide their clients with an effective means of expressing a view on the US market. With our long

"This move of unification of regulators is to be applauded." *Leo Melamed*

standing partnership we look forward to working together to create new opportunities for market participants. In addition, we are working with clients on how best to address their needs for option and volatility products and we are reviewing our options contract specifications to identify new opportunities.

Finally, allow me to state that I am sympathetic to the recent objections by the FSA and BOJ with respect to the extraterritorial aspects of proposed US legislation. They note the potential of a liquidity impact on non-US government securities markets. There is certainly food for thought in this regard. Further, I also believe that the Dodd Frank legislation, like the Sarbanes Oxley legislation, over-reached their intended objectives. At a minimum the legislation should be reviewed with an eye towards reducing some of their harmful consequences to the financial markets.

EB : Thank you for this interview and we also thank you for continuing to encourage and support Japan's derivatives market development.