

# FIX 津波 Tsunami in Japan

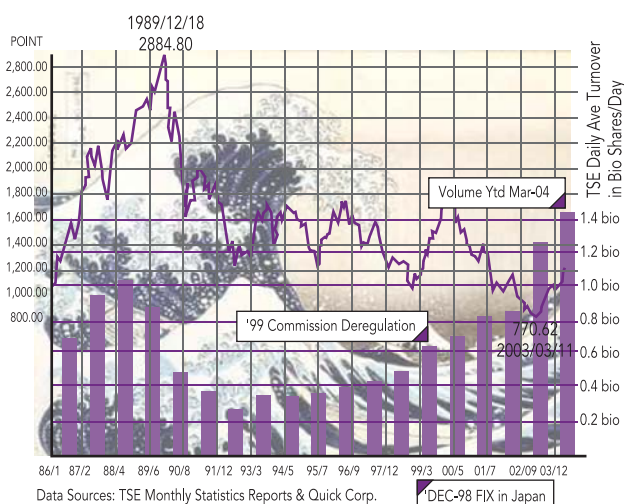
By Daniel Burgin, MetaBit

**To-date, a comprehensive FIX survey has never been conducted for FIX usage in the Japanese market. If the same questions were put to Japan's domestic financial market players as were posed during the 2003 FIX Survey in the US (undertaken by Tower Group on behalf of the North American FIX Protocol Organisation) it is probable that a very different picture would emerge.**

Traditionally, the Japanese market has always been split into discrete foreign and domestic segments, where the foreign part has been as transparent to the outside world as the domestic segment has been opaque. This article addresses the position of FIX in Japan within Japanese domestic companies rather than the foreign firms being represented in the market place.

The main question is why has there been so little FIX penetration within Japanese companies in the financial industry since the formalisation of the Japan FIX Committee in December 1998? This is in spite of the fact that trading volumes in Japan have grown dramatically in Japan over the past decade (Chart 1). This graph clearly shows the burst of Japan's Bubble Economy in 1989 when trading volumes collapsed and hovered at low levels until the late nineties. The 1999 commission deregulation and eroding commission revenues spurred a battle for market share in the equities secondary market. Increased trading volume was required simply to match the revenues from the pre-commission deregulation era. Since 1999, despite the ongoing struggle of Japan's economy and falling indices, trading volumes have continued to climb to similar heights as seen during Japan's Bubble Economy. On 14 April 2004, the Tokyo Stock Exchange hit a record high with trading volumes peaking at 3.129 bn shares, easily surpassing the previous record volume, registered on 6 July 1988 in the midst of the Bubble Economy. Chart 1 shows that trading volumes have not correlated with the index since 1999. The pattern has changed. With the establishment of the Japan FIX Committee, its subsequent version of FIX 4.1J and Japan's commission deregulation all taking place between December

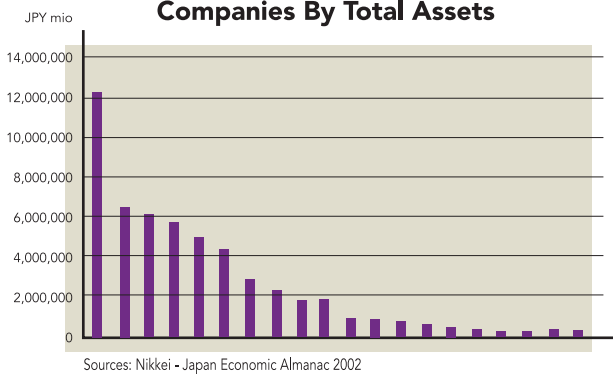
**Chart 1 - TSE's TOPIX since 1986 to 31/03/04  
Index & Volume**



1998 and December 1999, one would have expected a Japanese FIX tsunami (tidal wave) in the market. FIX, one would think, should have been embraced by the exchanges and the Japanese sell- and buy-side institutions alike in order to increase efficiency and contribute to greater liquidity in the market place. The industry's participants could have transacted higher volumes at lower costs and with reduced error handling.

With all of the events above, 1999 should have seen indications that the Japanese domestic industry would become more efficient in terms of catering for more trading flow through FIX. But it didn't.

**Chart 2 - Ranking of Japanese Securities Companies By Total Assets**

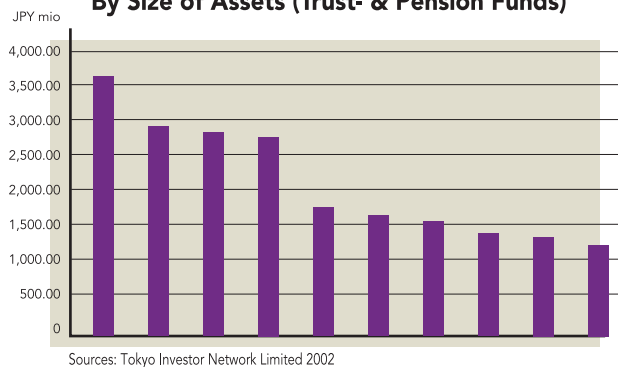


So what has happened? Chart 2 shows a list of Japan's 20 biggest domestic securities companies, ranked by assets. Virtually 100% of the global foreign players in Japan utilise a FIX engine, either locally or via a hub in their global network. However, most of Japan's registered domestic securities firms still do not use the FIX Protocol. The (April/May) 2003 Tower Group Survey in the US showed that 97% of 37 sell-side firms interviewed utilise FIX. If such a question had been asked of 37 Japanese securities firms (excluding foreign firms), fewer than 50% would have responded positively. It would have been assumed that the top-tier securities firms would have introduced FIX into their trading systems. However, many mid- to small-sized domestic firms are still slow to adopt FIX.

If the same survey was conducted amongst Japanese buy-side institutions, it would have resulted in an even lower percentage. Chart 3 ranks Japan's ten largest asset managers. Only a few of these firms are utilising a FIX engine or have adopted FIX indirectly by means of a third-party trading system, to facilitate transaction flow to/from their brokers.

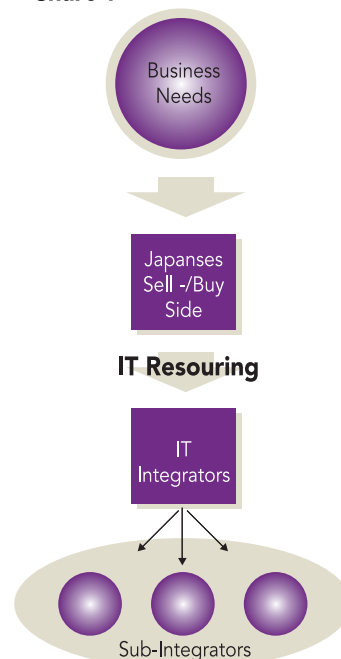
One would assume that, considering their size of assets under management, a natural growing demand for FIX engines and FIX connectivity should have come up since 1999 in order to shorten trading life-cycles, create efficiency in straight-through processing (STP) and reduce errors in trading.

**Chart 3 - Japan's 10 Largest Asset Mangers - By Size of Assets (Trust- & Pension Funds)**



How does the Japanese industry process its IT requirements? For specialised IT projects, large Japanese sell- and buy-side firms tend to outsource to a pool of Japanese software companies that act as integrators and provide technical expertise to a securities firm or asset manager's core IT department. Traditional integrators utilise an extended network of partner firms that fill potential gaps in the integrator's skill-set or simply provide additional resources (Chart 4).

**Chart 4**



Sources: MetaBit

There is a knowledge gap in FIX awareness within Japan's system of IT integrators and their partner network. Most of the integrator firms, apart from two, have limited or no experience in FIX connectivity and FIX engines. Until 2003, Japanese integrators provided their buy- and sell-side clients IT solutions that were helping STP and market liquidity, based on legacy IT technologies dating back to the eighties or mid-nineties. The business demand for performance and fast access to liquidity became subordinate to the needs of Japanese-language software dovetailed with interfacing requirements to traditional order routing and settlement systems.

Japanese software integrators were not driven by their clients to create IT solutions based on new technologies. Further to the absence of in-depth FIX knowledge within the Japanese domestic financial industry and local software suppliers, the Japanese exchanges do not appear to have spearheaded the education of FIX in their own market place. The Tokyo Stock Exchange offers a FIX gateway, but is known to have very few market participants utilising the FIX infrastructure. A similar situation seems to exist at Osaka Securities Exchange: OSE built a proprietary FIX engine that was integrated into its trading system and has a small number of brokers connected. Both exchanges understand the importance of FIX and also co-operate closely with their Asian and global counterparts. However, neither TSE nor OSE has offered the financial industry an upgraded, faster, simpler and cheaper FIX gateway into their exchanges, despite being two of the world's largest stock exchanges.

#### **2004: A turning point for FIX in Japan**

The FIX landscape in Japan has been changing rapidly since the beginning of 2004. So what are the main triggers? Large asset managers' demand for exercising tighter control over the execution of order flow has become a key driver for requesting FIX connectivity to their main brokers.

Operational and cost pressures are pushing asset managers to adopt a more integrated approach to IT solutions that promote STP. This is combined with an increased demand for best execution and a diversification of execution methods that require reliable and fast electronic access to their many sell-side brokers. Japan's domestic institutions have begun to discover FIX as a cost-efficient alternative to investing in costly, traditional order management systems.

**Regulatory compliance:** FIX technology will allow Japanese buy-side institutions to link their internal trading systems, that have been developed with a strong focus on regulatory controls and compliance checks, with fast and multiple access to their sell-side brokers' market liquidity. Buy-side institutions in Japan require large amounts of trade information in order to respond to frequent inspections by Japan's regulatory bodies, the FSA (Financial Services Agency) and SESC (Securities Exchange Surveillance Commission). The integration of FIX will help to support regulatory inspections in a more efficient manner.

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A Japanese tidal wave, a FIX tsunami, will engulf the Japanese domestic market place, altering the landscape with regard to FIX awareness and usage between now and the end of 2005. The current trend in Japan will – over the next 12 to 18 months – see Japanese buy-side institutions triggering this FIX tsunami, pushing small- and medium-sized Japanese sell-side firms to engage the FIX Protocol. Japanese domestic sell-side firms will be driven to think about ways to connect their buy-side clients. They will react to buy-side institutions that have acquired a new technical infrastructure that allows them fast and efficient connectivity with their brokers. It is a logical consequence that FIX-enabled buy-side institutions will, in order to achieve increased STP efficiency, reward those brokers that are capable of receiving order flow and sending executions electronically. Exchanges will subsequently follow with enhanced, powerful FIX gateways.

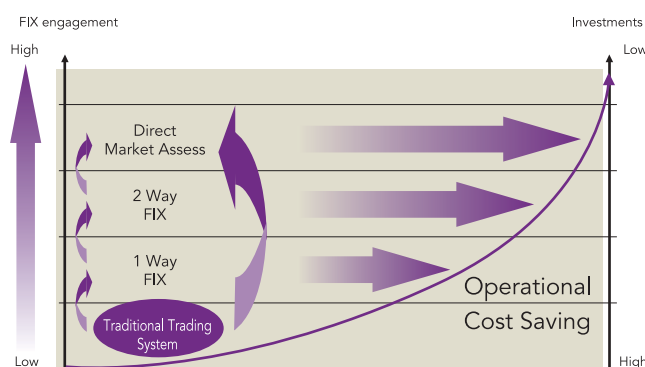
Japanese buy-side institutions are now in the process of analysing FIX within various internal projects. FIX will become an integral part of their current IT infrastructure, more efficiently linking existing OMS with well established domestic settlement and position keeping systems. They expect to achieve enhanced performance, accuracy and efficiency within the trading life cycle, combined with the reduction of manual and operational errors.

Buy-side institutions in Japan are now associating FIX with a genuine desire to better control their own orders and reduce dependency on their sell-side counterparts. FIX, and its ultimate form of Direct Market Access, is increasingly recognised as the tool to better control their own trades.

Due to changes in investment allocations, more Japanese buy-side institutions are developing IT strategies to help promote their investments into foreign markets. The primary focus is on Asia and China. FIX connectivity will not only enhance a Japanese buy-side firm's domestic order flow, but will dramatically open access to market liquidity outside Japan. For Japanese institutions that have deployed FIX, suddenly any FIX-enabled exchange or broker in any market in the world is within reach of the domestic infrastructure at limited additional expense and without compromising existing procedures, infrastructures and local compliance rules.

In 2004, FIX for Japan's domestic industry has gained strong momentum. Yet, it is still at a stage where misperceptions of FIX exist. Most of Japan's industry utilises FIX version 4.1 or 4.1J and is very cautious to embrace FIX 4.2 or 4.3 for (unfounded) concerns of compatibility.

**Chart 5**



A key advantage of FIX for Japanese buy-side institutions is that with almost the same infrastructure in place, they will have the choice to define their own entry-level for electronic trading. Currently, some large buy-side institutions evaluate FIX by means of Direct Market Access and integration with internal systems. However, the present demand for One-Way-FIX (FIX-enabled executions) attracts a larger market segment that wishes to manually control its order placement but tries to achieve electronic integration of executions with their internal

systems. Chart 5 shows a Japanese institution's assessment of FIX versus its financial investment. The move from current traditional high-cost trading methods to two-way-FIX or DMA is being seen as an eventual reduction of investment for IT infrastructure and of recurring operating costs.

In summary, Japan's FIX tsunami is triggered by the following factors:

**Market recovery**, as seen over the past few months, with a rising index. Market volatility and continuous high order volumes will allow Japan's financial market participants to look afresh for careful investments into IT projects. This will further help to increase profitability in terms of access to market liquidity pools and the reduction of operating costs.

**Regulatory changes.** Japan has continuously embarked on regulatory changes since 1997's 'Big Bang'. Following this 'Big Bang', which ultimately took the form of a series of deregulation items over a period of years, the market seems to finally be improving. In particular, commission deregulation in 1999 triggered the need to fight for market share in trading volume in order to recover some of the lost commission business. Coincidentally or not, almost at the same time, the establishment of the Japan FIX Committee planted the seed for efficient volume handling, raising FIX awareness in the market. In 2003, average pricing for executions was finally allowed by the Japanese regulators, which sparked renewed interest in FIX by Japan's buy-side institutions. In recent months, momentum was gained that continues today.

Buy-side institutions' demand improved efficiency of the trading operation, due to the move towards electronic trading, combined with an increased appetite to invest assets into overseas markets.

The domestic industry's call in Japan to achieve greater STP efficiency at less cost will compel a new generation of local software firms to offer FIX-embedded, high quality technical solutions that allow electronic access to a global network of market liquidity at better costs.

It can be hoped that FIX education and awareness in Japan will increase in the form of seminars and workshops that address the practical issues of the FIX Protocol and focus on how FIX could become a winning factor for the needs of the Japanese domestic industry. **FIX**