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Two Barriers Hindering the Integration of Stock Exchanges and the “Japan Exchange” Initiative

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The world has seen a wave of proposed mergers between leading stock exchanges such as that between the London Stock Exchange Group and the TMX Group and that between NYSE Euronext and Deutsche Börse. As a background factor behind these moves, there is the issue of increased competition involving exchanges and off-exchange trading venues such as proprietary trading systems (PTSs).

Given the highly public nature of a stock exchange in that it is responsible for operating the critical infrastructure of a country's economy, the mention of any consolidation with an overseas exchange tends to give rise to an emotional backlash that is rooted in nationalism along with criticism being voiced such as "impairing the national interest." The barrier of "national interest" is a major hindrance to the cross-border integration of stock exchanges.

Moreover, the integration of stock exchanges also poses a problem from the viewpoint of antitrust laws. The proposed merger between NYSE Euronext and Deutsche Börse to form the world's largest stock exchange was abandoned on the grounds of conflicting with the EU Competition Law.

In Japan, the Tokyo Stock Exchange Group (TSE) and Osaka Securities Exchange (OSE), which have been rivals for 130 years, are slated to merge to form the "Japan Exchange Group." There are great hopes for the benefits that are expected to be brought about by the planned merger such as the integration of the TSE and OSE systems. While at first glance, this combination appears to build a monopolistic position in the Japanese market, any antimonopoly challenges would be outweighed by increasing global competition as well as by concerns over a relative decline in the presence of the Japanese market.

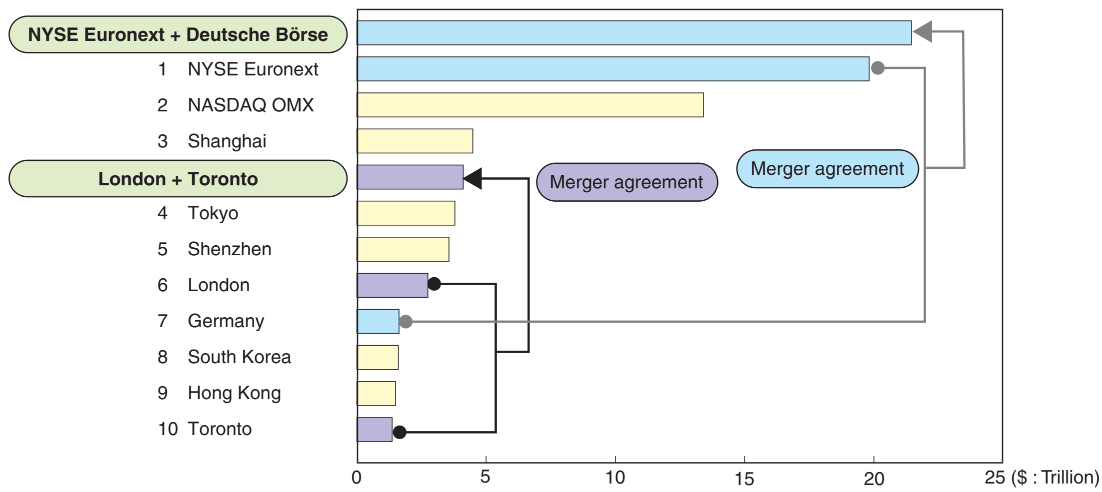
I A Spate of Exchange Integration Initiatives

In February 2011, the UK's London Stock Exchange Group (LSE) and Canada's TMX Group, which operates stock exchanges such as the Toronto Stock Exchange, entered into a merger agreement. At almost the same time, NYSE Euronext, which manages the New York Stock Exchange (NYSE) and European stock and futures exchanges, announced their plan to merge with Deutsche Börse. Because both of these agreements involve the mergers of exchanges that are among the world's top 10 exchanges in terms of stock trading value, these initiatives drew a huge amount of attention from people involved in the securities markets (Figure 1).

Also in February, BATS Global Markets (BATS), a leading operator of electronic markets in the U.S., announced the acquisition of Chi-X Europe, the largest alternative trading system (equivalent to the proprietary trading system (PTS)) in Europe. Relatively speaking, because the organizations involved in this takeover are not so well known, this merger did not attract so much attention. Nevertheless, if realized, this merger would create Europe's largest stock exchange in terms of trading value—bigger even than the LSE.

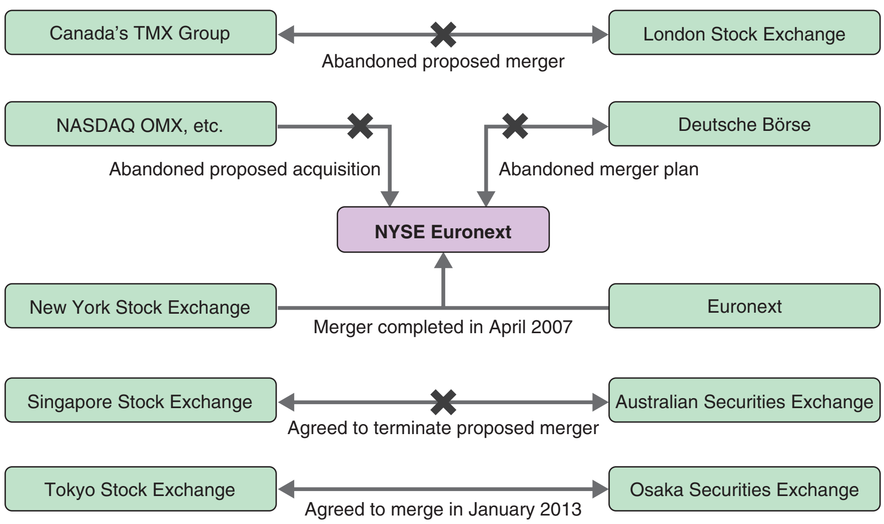
Since September 2000 when the Paris Bourse, Amsterdam Stock Exchange and Brussels Stock Exchange were merged to form Euronext, the world's stock exchanges have been toying with restructuring that extends beyond national boundaries. While these efforts were briefly stalled during the global financial crisis of 2007 – 2008, a series of announcements made since then clearly gave the impression that the restructuring of global stock markets has entered its second act.

Figure 1. Positioning of the new two exchanges to be created if proposed mergers are completed among the world's top 10 exchanges by value of shares traded in 2010



Source: Compiled based on material published by the World Federation of Exchanges.

Figure 2. Diagram of exchange merger initiatives



Source: Translated from "Shukan Ekonomisuto (Weekly Economist)," February 21, 2012, p. 18, courtesy of Mainichi Shimbunsha.

As of March 2012 when the author wrote this paper, however, the only merger that has been successfully completed was BATS' acquisition of Chi-X Europe. Two other initiatives mentioned above have fallen apart. The proposed merger attempt between the Singapore Exchange (SGX) and the Australian Securities Exchange (ASX) that was agreed upon in October 2010 was also abandoned (Figure 2).

Even in Japan that had so far been thought of as being outside a global wave of mergers, there was new movement. In March 2011, it was reported that talks began on the merger of the Tokyo Stock Exchange Group (TSE) and Osaka Securities Exchange (OSE). In November of the same year, the proposed merger was formally announced. The two bourses are scheduled to merge in January 2013, inaugurating a combined holding company, "Japan Exchange Group."

In the following chapters, the factors that frustrated a series of planned mergers around the world, as described above, are examined. While so doing, consideration is given to the future of the proposed merger between the TSE and OSE as well as to its significance.

II Background to the Integration of Stock Exchanges [Note 1]

1 Integration of exchanges in the past

To begin with, what are the dynamics behind the moves to integrate exchanges within any one country or across national borders?

The integration of exchanges is, in itself, not at all unusual. Rather, if we look back at past trends, the history of exchanges in each country up until the mid-1990s manifests itself as consisting of procedures in which regional exchanges within a country were integrated into major exchanges located in financial centers (there can actually be more than one major exchange in any one country).

For example, in 1973, all of the UK's local exchanges were integrated into the LSE. In 1988, France set up a common nationwide listing system and abolished all of its local exchanges. In 1993, the Frankfurt Stock Exchange, which is the largest exchange in Germany, became Deutsche Börse as a holding company operating local exchanges.

In the Meiji era, Japan had nearly 50 securities exchanges throughout the country. However, in 1943, the de facto government-operated Japanese Stock Exchange was formed, at which time the National Mobilization Act (which provided for government controls over civilian activities during wartime) was still in effect. Eleven exchanges from around the country joined this exchange. After World War II, securities trading recommenced with nine exchanges. However, in 1967, the Kobe exchange was dissolved. Since 2000, the Hiroshima, Niigata and Kyoto exchanges were absorbed into either the Tokyo Stock Exchange or the Osaka Securities Exchange.

In many countries, the major reason behind the integration of regional exchanges into central exchanges is the fact that with the development of a means of transportation and communication as well as the increased concentration of financial functions in major cities, the past mechanism in which securities issued by local companies were traded in local exchanges was no longer reasonable. In other words, the regional exchanges that disappeared through integration completed their historic mission.

2 Characteristics of the integration of exchanges in recent years

Characteristics that are very different from those in the past have been seen in the integration of exchanges in recent years.

First, the integration of exchanges in the past was generally meant to abolish or give relief to exchanges that were no longer economically viable. However, the rationale behind the integration of exchanges in recent years has been to increase the scale of exchanges as businesses and to make them more competitive.

Since the mid-1990s, with progress in electronic securities trading systems and given increasingly globalized securities trading, competition from proprietary trading systems (PTSs) and overseas exchanges has intensified. To effectively meet this situation, more and more exchanges in countries around the world have been transforming themselves from traditional membership-based organizations to joint-stock companies. An exchange that is set up as a joint-stock company must operate a business that has a high public nature, i.e., operate the markets in a way that ensures fair pricing. At the same time, the exchange must also pursue the maximization of corporate value as a profit-making company. One strategy for achieving this seemingly ambivalent goal is to partner with an overseas exchange or with an exchange dealing in commodities that the exchange has not handled in the past.

One effect that validates this strategic direction in the integration of exchanges in recent years is that while exchanges as business entities are combined, the markets that they operate often remain separate. In the past, exchange mergers were often accompanied by the abolition of the markets that lost their economic functions. However, recently, because the purpose of a merger is to strategically take on new markets, there has been no need for market consolidation or abolition.

The second characteristic, which somewhat overlaps the feature described above, is that the integration of exchanges in the past basically stayed within the same category in terms of the markets operated by the exchanges, which handled securities such as equities. However, recent mergers have not been limited to those between exchanges handling only securities, but have also involved exchanges dealing in derivatives (in terms of Japan's laws and regulations, in some cases, the Commodity Exchange Act is also applicable to derivatives exchanges in addition to the Financial Instruments and Exchange Act).

Third, while the integration of regional exchanges in the past was a rather one-sided process of consolidation that saw the disappearance of those exchanges, recently we have seen the integration of existing exchanges being simultaneously accompanied by the creation of new exchanges and PTSs. As such, the net result is not necessarily a reduction in the number of market operators or in the number of markets being operated.

For example, BATS, an electronic exchange in the U.S., which was mentioned in Chapter I, was founded in June 2005. In February 2006, BATS received de facto approval from the U.S. Securities and Exchange Commission (SEC) as an electronic communication network (ECN), which is a type of PTS. In 2008, BATS received SEC approval to operate as a registered national securities exchange. As such, BATS is still a young exchange. Chi-X Europe, which was acquired by BATS, is another PTS that was founded in March 2007. Japan has also seen the debut of new PTSs such as Chi-X Japan and SBI Japannext.

As described above, amid market competition in acquiring orders for trading equities and bonds as well as for derivatives transactions between exchanges and between exchanges and PTSs, the integration of exchanges in recent years is one of the strategic options chosen by the exchanges.

III "National Interest" Presents a Barrier to Stock Exchange Mergers

1 SGX-ASX merger proposal rejected

Ongoing cross-border stock exchange integration deals face some major barriers. One of these hurdles is "national interest."

In April 2011, Australian Deputy Prime Minister and Treasurer Wayne Swan stated that the proposed takeover of the Australian Stock Exchange (ASX) by the Singapore Stock Exchange (SGX), for which a merger agreement was entered into in October 2010, was not in the "national interest" of Australia.

Australia's Corporations Act requires any person who intends to acquire more than 15 percent of the shares of the stock exchange to provide notification to the Australian Securities and Investments Commission (ASIC) and gain the approval of the Treasurer. This Act stipulates that approval be granted "if the Minister (Treasurer) is satisfied that it is in the national interest to approve the applicant" (Section 851B (1)). Because Treasurer Swan rejected SGX's proposed takeover of the ASX, both exchanges announced the termination of the merger agreement.

For some time prior to formal rejection, both exchanges were aware that the government would not actually be in favor of this merger proposal through unofficial talks with the Australian government. In an effort to make the proposal more palatable for the government, the two exchanges made changes to the original plan. These changes included "an equal number of Australian and Singaporean directors" and "commitments to maintain operations, assets and key staff in Australia." Unfortunately, these efforts did not bear fruit.

2 LSE-TMX merger frustrated by nationalism

In February 2011, the merger agreement between the LSE and TMX Group was announced. However, opposition was raised against this proposed deal within Canada regarding the fact that TMX shareholders would hold only a 45-percent equity stake in the newly merged company. Against this backdrop, in May 2011, Maple Group Acquisition Corporation (this corporation has no relationship with Maple Financial Group, a global financial organization based in Canada, founded in 1986), which was formed by five of the country's largest pension funds and four Canadian bank-owned securities firms, announced an offer to acquire the TMX Group under terms that were superior to those offered by LSE.

The board of directors of the TMX Group considered that the Maple proposal did not constitute a superior proposal for reasons such as greater outstanding debt if the proposal were to be completed, and attempted to push ahead with its scheduled merger with the LSE. However, because the Maple Group increased its offer price, the shareholders' meeting was expected to see many shareholders who were no longer in favor of the proposed merger with LSE. In June 2011, because of a lack of shareholder support, the TMX Group board officially announced that the proposed merger with LSE was abandoned.

As is well known, the leaf of the maple tree is a symbol of Canada that also appears on the country's flag. It would be natural to feel strong nationalistic pride from the fact that "maple" was used in the name of the acquisition consortium formed against the takeover of the TMX Group by LSE of the UK, which is the former colonial power. Unlike the case in Australia, the Canadian government did not overtly intervene in the proposed merger between the TMX Group and LSE. Nevertheless, this is another example of "national interest" frustrating cross-border deals.

3 No rationality behind the idea of "national interest"

Exchanges have a highly public nature in that they are responsible for operating the securities markets that constitute a very important part of a country's economic infrastructure. From this perspective, people might easily lean toward the idea that if an exchange is dominated by foreign capital, it could be "contrary to the national interest."

However, if we examine this idea a little more deeply, it actually becomes difficult to identify exactly how a foreign-owned exchange could harm the national interest.

Even if the controlling shareholder is a foreign entity, an exchange is subject to domestic laws. In light of the public interest or investor protection, if there are any major problems in the operation of the exchange, the exchange will be subject to the denial of approval for changes in the exchange rules as well as to administrative sanctions. Japan's Financial Instruments and Exchange Act provides a strong means of control, which enables the Prime Minister to order the exchange to dismiss an officer if the officer violates laws, regulations or administrative disposition (Article 150, Paragraph 1). The government can readily step in and stop any unfair act conducted by a foreign-owned exchange operating company such as instituting listing rules that unilaterally favor companies from its own country, or adopting a mechanism or fee structure that is unfavorable to local securities firms.

A more realistic possibility is that an exchange-controlling foreign company may determine to withdraw from the market as a result of its interest in that exchange proving to be unprofitable. In fact, one of the reasons cited for the opposition to the acquisition of ASX by SGX was the fear that it could destabilize the Australian market in the future.

However, if the decision made by an exchange-controlling foreign capital company to withdraw from a market were rational, it would be difficult even for a domestic capital company to maintain that market. The situation involved here closely resembles what existed in the past when Japan's local exchanges were phased out. On the other hand, if such a decision by a foreign capital company were irrational, the result would simply be the replacement of the exchange by one controlled by a domestic capital company (or another foreign capital company), assuming that new entries into the market operation business are not prohibited. [Note 2]

If we make a shrewd observation, the rejection of control over an exchange by a foreign capital enterprise on the grounds of national interest strikes us as being based purely on emotion and lacking in rationality. Nevertheless, in a sense, nationalism, in particular, nationalism in relation to a country's economy, actually does have considerable power simply because it lacks rationality. This is why the barrier of "national interest" impedes cross-border exchange consolidation.

IV The Antitrust Law Constitutes a Barrier to Stock Exchange Consolidation

1 NASDAQ OMX abandoned its acquisition of NYSE

Another barrier that is positioned to derail efforts to merge exchanges is the regulations imposed by the antitrust law.

The February 2011 announcement of the planned merger between NYSE Euronext and Deutsche Börse had a major impact on NASDAQ OMX, which is responsible for operating the NASDAQ market. Since its inception 40 years ago, NASDAQ has viewed NYSE as a rival. Therefore, NASDAQ very much wanted to avoid seeing NYSE Euronext taking the unchallengeable position of the world's largest exchange as a result of the merger with Deutsche Börse.

In April 2011, NASDAQ OMX, jointly with IntercontinentalExchange (ICE), [Note 3] which operates multiple futures exchanges in the U.S. and Europe, made a counter offer to take over NYSE Euronext. This joint proposal consisted of plans to break up NYSE Euronext's operations, with NASDAQ OMX acquiring cash, equities and options businesses and ICE taking on derivatives markets centered on the London International Financial Futures and Options Exchange (Liffe).

If possible, of course, NASDAQ OMX must have wanted to bring all of the NYSE Euronext operations under its control. However, because NASDAQ OMX did not have sufficient financial resources to undertake, so to speak, a "the small fish eating the big fish" takeover alone, it looked to ICE for cooperation.

However, an unexpected challenge to this counterproposal was issued. In May 2011, the Antitrust Division of the U.S. Department of Justice informed NASDAQ OMX and ICE that it would file an antitrust lawsuit to block the deal if the joint proposal was not withdrawn. In its review of the joint proposal, the Department of Justice determined that the proposed acquisition would, if implemented, substantially eliminate competition for initial public offering (IPO) services and off-exchange stock trade reporting services.

2 EU Competition Law blocked merger between NYSE Euronext and Deutsche Börse

After recognizing they would not be successful in securing regulatory approval, NASDAQ OMX and ICE announced that they were withdrawing their proposal to acquire NYSE Euronext. At the time, it appeared that the antitrust challenge that blocked the rival proposal opened the way for the planned merger between NYSE Euronext and Deutsche Börse. However, this merger plan was eventually derailed. This time, the barrier was in the form of the European Union (EU) Competition Law.

The original aim of NYSE Euronext to merge with Deutsche Börse was not just to gain access to the German cash equity market with the Frankfurt Stock Exchange accounting for a very large share of the turnover. Rather, the major aim behind the move was to combine with Eurex, which is one of the world's largest derivatives exchanges, as well as Clearstream (formerly Cedel), which is a securities clearing and settlement company. Both Eurex and Clearstream are wholly owned subsidiaries of the Deutsche Börse Group. Within the U.S., there was opposition to the perceived advantage that would be given to Deutsche Börse by the merger ratio. However, the higher ratio merely came from the fact that the market capitalization of Deutsche Börse was higher than that of NYSE Euronext due to the high profitability of Eurex and Clearstream.

However, the authority responsible for competition policy at the European Commission determined on the basis of the EU Merger Regulation that the planned merger would create a quasi-monopoly in the area of derivatives markets and clearing and settlement operations, which was exactly the area that NYSE Euronext aimed at. While NYSE Euronext and Deutsche Börse revised their proposal in an effort to gain authorization from European regulators for the planned merger by promising strengthened remedies such as divesting assets in single equity derivatives business and licensing the Eurex trading system to a third party, they ultimately failed to gain approval.

In February 2012, the European Commission formally adopted its decision prohibiting the merger between the two exchanges. Deutsche Börse's CEO (chief executive officer) responded to the EU's decision by expressing his strong dissatisfaction, saying "this is a dark day for Europe and its future competitiveness on global financial markets." Nevertheless, without this decision being overturned, the idea of creating the world's largest exchange just became a dream.

V Significance of and Challenges Facing the "Japan Exchange" Initiative

1 Merger agreement between Tokyo Stock Exchange Group and Osaka Securities Exchange

One after another, initiatives to integrate stock exchanges that have attracted market attention stumbled when faced with the twin hurdles of national interest and antitrust laws, and were forced back to the drawing board. In Japan, the Tokyo Stock Exchange Group (TSE) and Osaka Securities Exchange (OSE), which have been rivals for more than 130 years since they were established in 1878 (with a short interlude during the war years when the government integrated the country's stock exchanges into the Japan Stock Exchange), have now entered into a merger agreement.

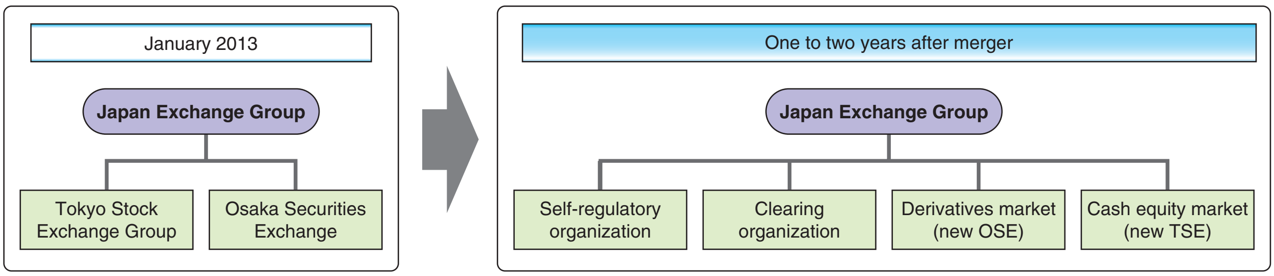
The merger will proceed as follows. At the first step, the TSE will launch a public tender offer for OSE shares listed on the OSE JASDAQ market. Because the number of shares that is to be purchased is set to be up to two-thirds of the outstanding OSE shares, the OSE will keep its listing even after this takeover bid. At the second step, in January 2013, the two companies will be merged, with the OSE being the surviving entity. After the merger, the TSE and OSE will come under one combined holding company. During the subsequent one to two years, the subsidiaries will be reorganized and a company group will be formed that will consist of four organizations under the holding company. They are the cash equity market, derivatives market, self-regulatory organization and clearing organization (Japan Securities Clearing Corporation (JSCC)) (Figure 3).

2 Expected merger effects

The merger between the TSE and OSE is expected to enhance the global competitiveness of Japan's exchanges.

Combining the TSE, which has an overwhelmingly large share in the cash equity market, with the OSE, which is strong in trading derivatives such as Nikkei 225 futures, will create a well-balanced exchange group as

Figure 3. Organization after the TSE-OSE merger



supported by strengths in both cash equities and derivatives. With the corporate scale being expanded, the management stability will be improved. The integration of trading systems, the use of a single settlement platform for derivatives trades and standardized self-regulatory functions will all lead to gains in efficiency.

While the TSE was sometimes criticized for its "bureaucracy" in the past, the organizational integration with the OSE that accumulated management expertise as a listed company will change its corporate culture in a positive direction. The fact that the TSE, which is now unlisted, will consequently become a listed company after the merger and will be subject to market evaluation will have a beneficial effect on the TSE in terms of its management discipline.

Nevertheless, market users such as listed companies and investors are unlikely to see any major benefits in the short term after the merger. This is because there is little possibility that improved efficiency after the merger will quickly lead to a reduction in the burden faced by listed companies and investors partly because the transaction fees (commissions) charged by Japanese exchanges are already at considerably low levels, as compared to international standards.

However, without any doubt, in the medium to long term, it is highly likely that an exchange that has built a stable management foundation and improved its efficiency will be able to offer a more convenient, highly liquid and efficient market to market users than those that have not done so. In the long run, the consolidation of the TSE and OSE will be seen as the right decision in the eyes of market users.

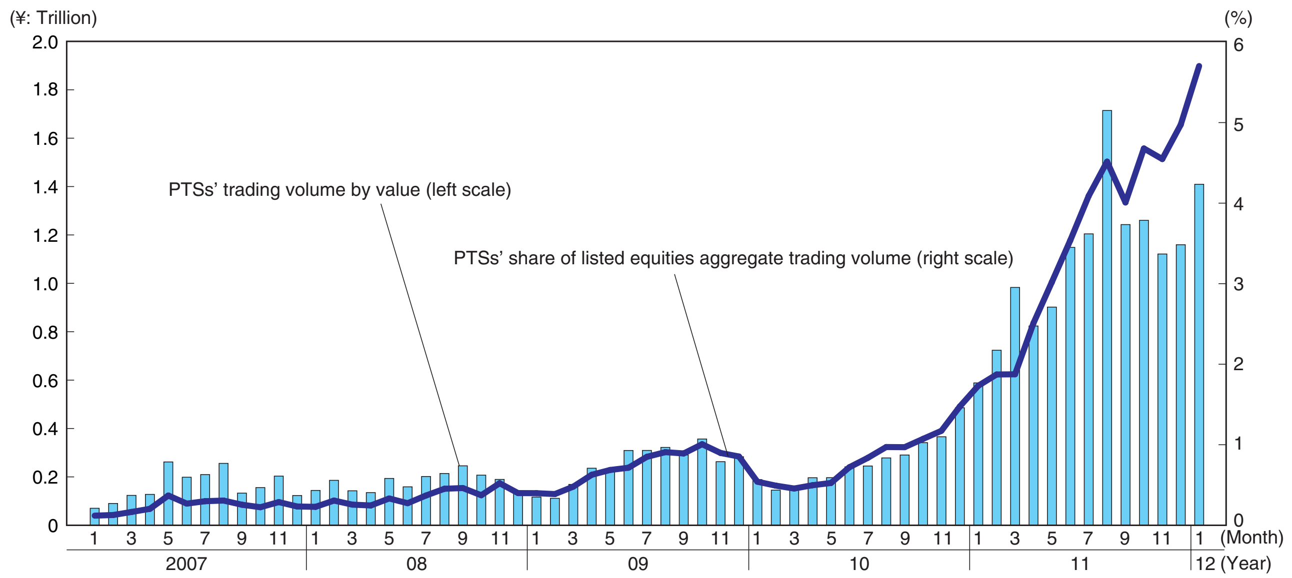
3 Challenges to exchange integration

The merger between the TSE and OSE, which should be evaluated positively as described in Section 2 above, is nevertheless subject to worries about conflicting with the antitrust laws, which derailed merger deals in other countries as described in Chapter IV. If we focus on market share within Japan alone, the Japan Exchange Group, born out of the merger of the two exchanges, will have around a 90- to 100-percent share in all of the following markets: cash equities, exchange-traded funds (ETF), initial public offerings (IPOs), securities derivatives and settlements involving equities and derivatives.

At this point, upon receiving an application for authorization from the two exchanges, the Japan Fair Trade Commission (JFTC) has been proceeding with the secondary review that involves a detailed investigation. Given that the proposed merger between NASDAQ OMX and NYSE Euronext as well as that between NYSE Euronext and Deutsche Börse were found to be in breach of the Antitrust Law, people could be forgiven for thinking that the merger between the TSE and OSE would also fall afoul of the same law. However, it is not fair to make such a prediction without actually taking a much closer look at the situation in which Japanese exchanges find themselves.

For example, Japanese cash equities are also traded via PTSs. While currently, the PTS share is just slightly more than 5 percent, it has nevertheless been rising notably in recent years (Figure 4). For IPOs, local exchanges have been opening new markets one after another to such an extent that there is criticism that they are "mushrooming." In the case of securities derivatives, Nikkei 225 derivatives, which are one of the core products of the OSE, are also traded on the SGX and Chicago Mercantile Exchange (CME). In particular, because its trading hours overlap those of the OSE, the Singaporean market presents greater direct competition. The situation in the U.S. IPO market where the U.S. Department of Justice pointed out that the acquisition would substantially eliminate competition and the situation in the

Figure 4. Domestic listed equities' trading volume via PTSs



Source: Compiled based on material published by the Japan Securities Dealers Association.

European financial derivatives market where the European Commission ruled that the proposed merger would result in a quasi-monopoly and new competitors would be unlikely to enter the market successfully enough to pose a credible competitive threat to the merged company are both very different from that in Japan.

If we take a slightly wider perspective, we see that the Japanese market has been locked in fierce competition with Hong Kong, Singapore and Shanghai to secure the position as Asia's financial center. Note 4 Because Japan is a developed country in relative terms within the region, there is even more concern over a decline in the presence of the Japanese market with the rise of the markets of emerging economies in Asia. Note 5 Far from being able to rest on its monopolistic position, the newly born Japan Exchange Group will only be a challenger who must rise up to face intensifying international competition to survive.

Of course, besides the pressure of international competition, without a healthy level of competition in the domestic market, it would not be possible to eliminate concerns over the combined exchange being prone to lax management discipline. Note 6 To retain such a level of competition in the domestic market, it will become necessary to review the regulations that are claimed to be impeding the increased use of PTSs by institutional investors and to revitalize the new markets operated by local exchanges, which have seen almost no IPOs in recent years. Note 7

"National interest," which prevented merger deals from going ahead in other countries, conversely constitutes a favorable wind helping along the merger between the TSE and OSE. This is because raising the significance of the Japanese market as a whole through the merger of the two exchanges is required from the perspective of protecting the national interest of Japan. This consolidation must accompany efforts to maintain a competitive institutional environment in which multiple players can compete.

Notes:

1 This chapter consists of the statement appearing on Page 22 and subsequent pages of the following paper written by the author, which was rewritten by the author for this paper: "Shoken torihikisho no kyoso to togo (Competition and Integration of Stock Exchanges)" (*Horitsu Jiho* Vol. 81, No. 11, 2009).

2 The withdrawal of Nasdaq Japan in August 2002 can be cited as an example. In June 2000, the Osaka Securities Exchange opened the Nasdaq Japan Market in partnership with NASDAQ Stock Market, Inc. of the United States. However, because Nasdaq Japan was not as profitable as anticipated, NASDAQ decided to terminate the partnership agreement and pull out of Japan. Even after NASDAQ's withdrawal, the exchange was renamed Nippon New Market—Hercules and continued operation without any trading interruptions.

3 Founded in May 2000, ICE is a rapidly growing derivatives exchange through its globally distributed electronic platform. In January 2007, ICE acquired the New York Board of Trade (NYBOT), which was formed in 1998 for trading commodities such as coffee, cocoa and sugar. In recent years, ICE has expanded its trading activities into weather derivatives.

4 Moreover, it is not uncommon to find countries in Asia where there is a single stock exchange in a country (region) such as South Korea, Hong Kong, Australia and Singapore.

5 A sense of crisis about a decline in the international presence of the Japanese market can also be seen behind the Japanese government's recent move to combine financial instruments exchanges such as stock exchanges with commodity futures exchanges where precious metals and grains are traded under its plan to create a comprehensive exchange.

6 On February 2, 2012, the trading of 241 TSE-listed issues was suspended for a half day due to a TSE system failure. At this time, the trading of issues that were also listed on the OSE was not affected, proving that the existence of multiple exchanges can provide backup functions. While it is expected that cash equity trading systems will be integrated through the TSE-OSE merger, the presence of competing exchange operators will have great significance as a backup after the integration of TSE-OSE systems.

7 Because transactions via PTSs are considered as purchases outside a financial instrument exchange market, Article 27-2, Paragraph 1, Item 1 of Japan's Financial Instruments and Exchange Act requires the purchase of shares by means of a tender offer if a person purchases shares from more than ten persons within 60 days and if, after such purchase, the number of shares owned by that person exceeds 5 percent of the issued shares. Because it is not uncommon that the number of shares owned by institutional investors exceeds 5 percent of the issued shares, investors who fear unintentional conflict with this provision tend to be unwilling to purchase shares through PTSs.

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