

The Implications of Cboe Japan's Withdrawal – Structural Changes in Japan's Stock Market

Manabu Morimoto

Abstract

At the end of August, Cboe Japan terminated its PTS—equivalent to the United States' ATS—operations in Japan. Cboe—the Chicago Board Options Exchange—is, needless to say, one of the three major exchange groups in the United States, and since its entry into Japan in 2021 via acquisition, its business development had attracted significant attention. Behind this unexpectedly early withdrawal, which leaves Japan with no independent PTS, lies the rapid move among major Japanese retail brokers toward the internalization of equity order execution. This trend was triggered by the elimination of online trading commissions as well as mechanisms similar to Payment for Order Flow (PFOF) seen overseas, and it is likely to persist. As a result, the structure of Japan's equity market is becoming unique, consisting of the Tokyo Stock Exchange (TSE) as the sole multilateral trading venue and, alongside it, multiple internalized markets. This signifies a fundamental transformation in “inter-market competition,” and maintaining an appropriate competitive environment will require the development of new market rules.

Cboe's Entry into Japan

In 2021, Cboe entered the Japanese market by acquiring Chi-X Japan and Chi-X Australia. This was referred to by some as the arrival of a “Black Ship,” the first since Nasdaq Japan in 2000. At the time, Cboe CEO Fredric Tomczyk stated, “Japan is a large market. We want to be involved for the long term,” and expressed an ambition “to increase market share and eventually become an exchange recognized under the Financial Instruments and Exchange Act (FIEA).” He also remarked, “Multiple exchanges are necessary to build a competitive market in Japan.”

Since becoming an exchange in Japan would require addressing the absence of Unlisted Trading Privileges (UTP) and the 20% ownership cap on major shareholdings in exchanges, he signaled early on that Cboe wished to discuss these issues with regulators.

Reasons for Cboe's Withdrawal

The direct reason for Cboe Japan's exit from PTS operations was the effective cessation of order flow from Rakuten Securities. Cboe Japan held a 4–5% share of equity trading—

ranking second among PTSs after SBI Japannext—but 60–70% of its orders came from Rakuten Securities. Rakuten, however, launched its own PTS (“JAX”) in December 2024, and as a result, the flow of orders to Cboe Japan was gradually reduced and had almost ceased by this summer. Cboe thus concluded that Japan’s market environment offered no business prospects and decided on an early withdrawal—a decision whose speed was itself striking.

Background to the Internalization of Equity Order Execution

As noted earlier, in 2024, Rakuten Securities launched its own PTS, while SBI Securities began executing its own orders in its proprietary dark pool called “SBI Cross” (in April). Rakuten Securities had already been executing through its own dark pool (“R-Cross”), and SBI had been executing via its proprietary PTS, SBI Japannext. Thus, by last year, Japan’s two major retail brokers had established systems prioritizing internal execution via proprietary PTSs or dark pools.

Why, then, do major retail brokers seek to operate their own PTSs or dark pools and execute their own orders there?

Retail order flow is generally highly valuable for predicting market trends, and market makers—today, essentially high-frequency traders (HFTs)—are willing to *pay* to execute such orders, rather than charge for execution. In the United States, major retail brokers (such as Charles Schwab and Robinhood) route retail orders to wholesalers—effectively HFT firms such as Citadel Securities—and receive what is known as PFOF (Payment for Order Flow).

In Japan, this mechanism has been internalized: major retail brokers treat their internal PTSs or dark pools (hereafter, “internalized PTSs”) as the primary venues for executing their own orders, collecting significant fees from participating market makers (HFTs). These revenues finance the “zero-commission” online trading programs introduced in autumn 2023. Indeed, the zero-fee plans of SBI Securities (“Zero Revolution”) and Rakuten Securities (“Zero Course”) explicitly require priority execution in internalized PTSs or proprietary dark pools.

Transformation of “Inter-Market Competition”

“Promotion of inter-market competition” has been a doctrinal principle of Japan’s financial regulation since the 1998 Financial Big Bang when the concentration on exchanges was abolished. During the TSE and Osaka Securities Exchange merger, regulators positioned PTSs as TSE’s principal competitors (the Financial Services Agency (FSA) encouraged PTS growth through deregulation, and the Japan Fair Trade

Commission approved the merger on the grounds that TSE would still face competitive pressure from PTSs (2012)).

With Cboe Japan's withdrawal, there are no longer any independent PTSs in Japan. This means that TSE has effectively become the only multilateral venue matching orders from a wide range of broker-dealers. Aside from some limited external order flow, other venues are essentially internalized PTSs or proprietary dark pools, and—except vis-à-vis the TSE—there is almost no competition among them (a “Japan-style market structure”).

Currently, SBI Securities and Rakuten Securities execute margin trades primarily on internalized PTSs and cash equity trades through dark pools because margin trading cannot legally be executed in dark pools under FSA rules. If that restriction were lifted, it is widely believed that PTS trading would shift substantially to dark pools, which have lower operating costs and greater flexibility.

In short, no multilateral venue comparable to TSE remains, and even where “inter-market competition” exists, it increasingly resembles a form of “mixed martial arts match”, a contest among those with considerably different natures.

Origins and Evaluation of the Japan-Style Market Structure

Why has Japan's equity market come to take this form? Historical consolidation around TSE is, of course, part of the reason, but the disappearance of multilateral PTSs—despite the initial entry of many—appears also to stem from other factors.

In the U.S., roughly 50 trading venues coexist, many of them multilateral. A key reason is the NBBO (National Best Bid and Offer) requirement: if a venue shows even slightly better quotes, orders from across the country will automatically be routed to it, dramatically lowering entry barriers.

Japan's best execution policies, on the other hand, do not necessarily require brokers to compare prices across multiple venues; they require disclosure of "markets to be compared" and "methods of market selection," among other items. Thus, the best execution policies of online brokers such as SBI and Rakuten focus primarily on comparing prices between their own internalized PTS or dark pool and TSE. Such regulatory differences have contributed to the extreme polarization of Japan's equity market (TSE as the sole multilateral venue + internalized markets).

In 2022, the Financial System Council's Working Group on Market System recommended relaxing the trading volume cap on auction-style PTS trading to “improve market infrastructure function” through “appropriate inter-market competition”. During the deliberations, some suggested that strengthened PTS functions could serve as alternatives in the event of a TSE system failure. However, under the current market

structure, it is very doubtful that PTSs could serve as substitutes for trading during a TSE failure. Without TSE's price formation—the only functioning multilateral venue—HFTs would find it difficult to make markets on PTSs, and retail brokers would hesitate to execute orders solely on the quotes of their internal venues without comparison against TSE.

Recently, PTS and dark pool market shares have risen sharply (from 8.8% → 12.2% for PTSs and 3.1% → 5.0% for dark pools between 2021 and 2025 (Jan–Jun)). Considering that major retail brokers completed their internal execution systems only last year and this year, this trend is likely to continue.

Need for New Rulemaking

The FSA has long emphasized the importance of “inter-market competition,” but it appears to have vaguely assumed competition among similar types of trading venues. As shown above, however, Japan's inter-market competition has become a “mixed martial arts match”. Future trading and market rules must therefore move beyond simple “market-vs.-market” constructs and address deeper issues such as relationships and incentives among market participants.

For example, in the United States, PFOF has raised concerns regarding conflicts of interest and best execution, leading to detailed disclosure requirements for retail brokers (including amounts of PFOF received). The U.K., Australia, and some EU jurisdictions prohibit PFOF entirely. The FSA stated that “no PFOF has been confirmed in Japan” (Financial System Council's Task Force on Best Execution's Report, June 2021), but economically equivalent mechanisms are developing internally. This requires discussion grounded in actual practice.

Furthermore, major retail brokers execute orders on their internal venues when prices are “equal to or better than” TSE quotes. They achieve this by setting tick sizes finer than those on TSE, enabling slightly better prices to appear. Europe and the U.S. define tick sizes as a market rule. Japan should also consider such rules to ensure fair competitive conditions in this “mixed martial arts match”.

Conclusion

In recent years—partly due to the zero-commission business models—the influence of major retail brokers and HFTs has grown in equity markets, both in Japan and the U.S. In Japan, the quantitative presence of online brokers such as SBI and Rakuten has become overwhelming (while many full-service brokers focus on mutual funds, wrap

accounts, and foreign equities). Similarly, the structure of Japan's equity market has undergone substantial qualitative change.

Cboe Japan's withdrawal is merely the decision of one business operator, but from the perspective of market structure, it may be a sign—like “one paulownia leaf falling, signaling the arrival of autumn”—that warrants broader reflection.

(End)