



## U.S. COMMODITY FUTURES TRADING COMMISSION

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Division of  
Market Oversight

CFTC letter No. 07-02  
March 6, 2007  
No-Action  
Division of Market Oversight

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Re: Tokyo Financial Exchange, Inc., Request for No-Action Relief from Contract Market Designation and Derivatives Transaction Execution Facility Registration Requirements

Dear Mr. Architzel:

This is in response to your letter dated January 12, 2007 to the Division of Market Oversight (Division) of the Commodity Futures Trading Commission (CFTC or Commission).<sup>1</sup> By this correspondence, you request, on behalf of the Tokyo Financial Exchange, Inc., (TFX or the Exchange) that the Division confirm that it will not recommend that the Commission take enforcement action against TFX or its members<sup>2</sup> if TFX does not seek designation as a contract market (DCM) pursuant to Section 5 of the Commodity Exchange Act (CEA or Act) or as a derivative transaction execution facility (DTEF) pursuant to Section 5a of the Act, or Commission rules thereunder, in connection with the installation and use by TFX members in the United States<sup>3</sup> of the Exchange's electronic trading and order matching system, as well as its Application Program Interface (API) (referred to hereafter as its trading system or LIFFE CONNECT™). (No-action request).

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<sup>1</sup> Letter from Paul M. Architzel, Esq., Alston & Bird LLP, to Richard A. Shilts, Director, Division of Market Oversight, Commodity Futures Trading Commission (January 12, 2007).

<sup>2</sup> For purposes of this letter and the relief provided herein, references to the members of TFX shall include any "affiliate" of any TFX member that has been granted access by the TFX member to the Exchange's trading system. An "affiliate" of a TFX member shall mean any person, as that term is defined in Section 1a(28) of the Act, that: (i) owns 50% or more of the member; (ii) is owned 50% or more by the member; or (iii) is owned 50% or more by a third person that also owns 50% or more of the member. TFX represents that, as a condition of access to the trading system, such affiliates would be required to comply with TFX Rules and that TFX members remain responsible to TFX for ensuring their affiliates' compliance.

<sup>3</sup> For purposes of this letter and the relief provided herein, the term "United States" shall include the United States, its territories and possessions.

Specifically, TFX wishes to make its trading system available through direct access<sup>4</sup> to TFX members in the U.S. that:

- (1) trade for their own accounts;
- (2) are registered with the Commission as Futures Commission Merchants (FCM) or that are exempt from such registration pursuant to Commission Rule 30.10 (Rule 30.10 Firms)<sup>5</sup> and that submit orders for U.S. customers<sup>6</sup> to the trading system for execution;
- (3) are registered with the Commission as commodity pool operators (CPO) or commodity trading advisors (CTA), or are exempt from such registration pursuant to Commission Rules 4.13 or 4.14, and that submit orders for execution on behalf of U.S. pools they operate or U.S. customer accounts for which they have discretionary authority, respectively, provided that an FCM or Rule 30.10 Firm acts as clearing firm and guarantees without limitation all such trades of the CPO or CTA effected through submission of orders on the trading system; and
- (4) are registered with the Commission as FCMs or are Rule 30.10 Firms and that accept orders through automated order routing systems (AORS)<sup>7</sup> from U.S. customers for transmission to the trading system.

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<sup>4</sup> For purposes of this letter and the relief provided herein, the term “direct access” refers to the explicit grant of authority by TFX to a TFX member to enter trades directly into TFX’s trading system.

<sup>5</sup> Rule 30.10 permits a person affected by the requirements contained in Part 30 of the Commission's rules to petition the Commission for an exemption from such requirements. Appendix A to the Part 30 rules provides an interpretative statement that clarifies that a foreign regulator or self-regulatory organization (SRO) can petition the Commission under Rule 30.10 for an order to permit firms that are members of the SRO and subject to regulation by the foreign regulator to conduct business from locations outside of the United States for United States persons on non-United States boards of trade without registering under the Act, based upon the person's substituted compliance with a foreign regulatory structure found comparable to that administered by the Commission under the Act.

Among the issues considered by the Commission in determining whether to grant Rule 30.10 relief to a foreign regulatory or self-regulatory authority are the authority's: (i) requirements relating to the registration, authorization, or other form of licensing, fitness review, or qualification of persons through whom customer orders are solicited and accepted; (ii) minimum financial requirements for those persons that accept customer funds; (iii) minimum sales practice standards, including risk disclosures, and the risk of transactions undertaken outside of the United States; (iv) procedures for auditing compliance with the requirements of the regulatory program, including recordkeeping and reporting requirements; (v) standards for the protection of customer funds from misapplication; and (vi) arrangements for the sharing of information with the United States. Interpretative Statement with Respect to the Commission's Exemptive Authority Under § 30.10 of its Rules, 17 C.F.R. Part 30, Appendix A (2006).

<sup>6</sup> For purposes of this letter and the relief provided herein, the term “United States customers” shall have the same meaning as the term “foreign futures or foreign options customers” as it is defined in Rule 30.1(c).

<sup>7</sup> For purposes of this letter and the relief provided herein, the term “AORS” shall be defined to include any system of computers, software or other devices that allows entry of orders through another party (an intermediary) that has been granted direct access for transmission to the trading system where, without substantial human intervention, trade matching or execution takes place.

As you know, the Commission, on October 27, 2006, issued a policy statement that affirmed the use of the no-action process to permit foreign boards of trade to provide direct access to their electronic trading systems from the U.S. (Policy Statement).<sup>8</sup> The Division has reviewed TFX's No-action request and the materials submitted in support thereof in accordance with the Policy Statement and the June 2, 1999, Commission Order (June 2 Order) which first directed the Commission staff to consider requests from foreign exchanges for interim no-action relief to allow them to provide direct access to their trading systems from the U.S.<sup>9</sup>

In connection with its No-action request, TFX has forwarded the following information to the Division:

- General information about TFX, including its history, location and organization;
- Information about membership criteria,;
- Information about various aspects of TFX's trading system (including the order-matching system, the audit trail, response time, reliability, security, and adherence to the IOSCO Principles) and information about settlement and clearing;
- Information about TFX's home country regulatory regime and information regarding TFX's status in its home jurisdiction and its rules and enforcement thereof (including market surveillance and trade practice surveillance);
- A description of current information-sharing agreements to which TFX and its regulators are parties;
- TFX's Articles of Incorporation;
- TFX's regulations;
- Lists of TFX's Trading and Clearing Members;
- Japan's Financial Futures Trading Law;
- Japan's Financial Instruments and Exchange Law;
- Certification of an authorized representative of TFX as to the truth and completeness of the material facts set forth in the No-action request; and

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<sup>8</sup> Boards of Trade Located Outside of the United States and No-Action Relief from the Requirement to Become a Designated Contract Market or Derivatives Transaction Execution Facility, 71 Fed. Reg. 64443 (November 2, 2006).

<sup>9</sup> Order of the CFTC Withdrawing Proposed Rules Regarding Access to Automated Boards of Trade, 64 FR 32829, 32830 (June 18, 1999).

- Undertaking of an authorized representative of TFX to notify the Commission staff if, prior to the issuance of no-action relief requested in the No-action request, any material representation made in such request ceases to be true and complete.

The Division also received separately from the Financial Services Agency of Japan (FSA), TFX's regulatory authority, a representation regarding the existing information-sharing arrangement between the FSA and the CFTC. This representation is described below in section VII.

Representations made by TFX regarding the structure of TFX, TFX's activities in the U.S., TFX's membership criteria, TFX's electronic trading and order matching system, the relevant regulatory regime in Japan, and the information-sharing arrangements applicable to TFX and its regulator are summarized in Sections I - VII below. For purposes of this response to the No-action request, the Division has relied upon TFX's representations and information provided by TFX and has not conducted an independent review to confirm their accuracy.<sup>10</sup>

## **I. GENERAL INFORMATION REGARDING TFX**

### **A. History and Organization**

TFX was first established in April 1989 as the Tokyo International Financial Futures Exchange (TIFFE) under Japan's Financial Futures Trading Law and was licensed to trade interest rate and other financial futures contracts. In June 1989, TIFFE began trading in the Three-month Euroyen futures contract, Three-month Eurodollar futures contract and Japanese Yen-US Dollar currency futures contract. Initially, TIFFE members placed orders by telephone with Exchange operators who would then input those orders into an electronic matching engine. In 1991, TIFFE installed a fully electronic trading system, listed Three-month Euroyen option contracts, and began an evening trading session. In April 1996, the TIFFE-SPAN®<sup>11</sup> Margin System was introduced and in November 1998, segregation of customer funds was instituted. In April, 2003, TIFFE, in collaboration with the London International Financial Futures and Options Exchange (LIFFE), implemented the LIFFE CONNECT™ trading system and its new clearing system developed by Fujitsu. In April 2004, TIFFE demutualized, becoming a shareholder-owned, for-profit company. In July 2005, TIFFE, Inc., was renamed the Tokyo Financial Exchange, Inc. TFX currently has 72 shareholders and, as of December 31, 2006, was capitalized in the amount of ¥5,844,650,000.<sup>12</sup>

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<sup>10</sup> As stated below, the no-action relief provided herein is contingent upon the accuracy of the representations made by TFX in support of its No-action request. Any materially different, changed, or omitted facts or circumstances may render the no-action relief void or cause the Division, in its discretion, to condition further, modify, suspend, terminate, or otherwise restrict the relief.

<sup>11</sup> SPAN® is the margin calculation system developed in 1988 by the Chicago Mercantile Exchange (CME). SPAN® is a registered trademark of the CME and used by TFX with permission of the CME.

<sup>12</sup> As of February 14, 2007, ¥5,844,650,000=\$48,119,458.

TFX is overseen by a seven-member Board of Directors (Board). Three Board members are officers of the company-- the president and chief executive officer, the senior managing director and chief operating officer, and the managing director. The Board is assisted in its operations by three standing Advisory Committees which study various proposals and recommend policies to be adopted and actions to be taken by the Board. The standing Advisory Committees include the Market Operation Committee for Interest Rate Futures Transactions, composed of a Chairperson, a Vice Chairperson and seven members, the Market Operation Committee for Exchange FX Margin Transactions, composed of a Chairperson and four members, and the Discipline Committee, also composed of a Chairperson and four members. In addition, TFX is required under the Company Act of Japan to provide for a Board of Statutory Auditors, which is comprised of a standing statutory auditor and two outside independent statutory auditors. The Board of Statutory Auditors provides independent oversight with regard to the operations of the company.

TFX has a staff of 72 people as of December 31, 2006. The staff of the Exchange is divided into four departments and two independent offices--the Compliance Office and the Inspection Office. The four departments include the General Administration Department, which handles general corporate functions, including budget and accounting. The Market Promotion Department includes those offices and groups that promote use of the Exchange and the contracts traded thereon. The System Department is responsible for operation of the trading system and allied IT systems. The Business Operation Department includes the clearing and settlement group and the market surveillance group and, in conjunction with two offices, the Administration Office and the Inspection Office, oversees members' trading and activities and takes disciplinary measures as appropriate in fulfilling TFX's responsibilities as a self-regulatory organization.

## **B. Products**

TFX proposes to make the following contracts available for trading via direct access:

- Three-month Euroyen futures contract (Euroyen futures contract)
- Three-month option of Euroyen futures contract (Euroyen options contract)

You represent that the Euroyen futures contract is the preeminent futures contract traded in relation to Japanese interest rates and as such, is a tool to hedge fluctuations in Japanese interest rates. The currency in which it is traded and cash settled is Japanese Yen, payable through settlement banks in Japan. The Euroyen options contract is an American-style option that is exercised into Euroyen futures contracts. You represent that the terms of these contracts have no nexus to the United States, nor do they raise any particular U.S. regulatory interest.

## **C. Presence in the United States**

TFX currently does not have a representative office in the U.S. Its activities in the U.S. are limited to participating in widely-attended industry conferences and trade shows to acquaint the futures industry generally with TFX, representing TFX at such events with respect to inquiries from the press, providing information of a general nature to prospective members and

industry groups and responding to inquiries from the public. TFX may also conduct seminars and other educational programs relating to trading on the Exchange. TFX does not provide investment services or accept, solicit, receive or direct orders in the U.S. with respect to products traded on the Exchange, and no trade processing or clearance functions are performed by TFX in the U.S. TFX's English-language website is located at: <http://www.tfx.co.jp/en/>.<sup>13</sup>

You represent that although TFX does not have any immediate plans to open a representative office in the U.S., it may do so in the future for the purposes of promoting and developing TFX's products in the U.S., carrying out representational activities with the Commission and the press, and providing information to existing and prospective members and others. If TFX does open a U.S. representative office, it would limit its activities to those discussed above. It would not provide investment advice or technical support from the U.S., nor would it solicit, receive or direct orders for the products traded on TFX.<sup>14</sup>

## **II. MEMBERSHIP**

### **A. Introduction**

In order to ensure fair and efficient financial futures transactions and the financial integrity of its market, TFX permits only TFX members to access the TFX market directly. Non-member market participants may access the TFX trading system only through a TFX member that, in order to act as an agent for such customers, must be a licensed financial futures broker. TFX has two types of members, trading members and clearing members. Trading members may execute trades on the exchange for their own accounts or if appropriately licensed, for the accounts of others. Clearing members are permitted to conduct clearing operations on behalf of others. They are also required to be licensed as financial futures brokers. Non-clearing members must enter into a clearing agreement with a clearing member that agrees to guarantee the non-clearing members' positions and are required to clear the positions they execute through a clearing member.

TFX requires that its members be fit and meet financial soundness requirements, as discussed below. In order to become a TFX trading member, an applicant must file an application and must be a financial institution. Accordingly, it must be licensed under the Banking Law, the Securities and Exchange Law, or have a similar business license and engage in a financial futures business. Thus, TFX members cover a broad range of financial sectors such

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<sup>13</sup> TFX's website includes general information relating to the Exchange, its corporate organization, the contracts traded thereon, and the operation of the trading system and of the market. In addition, TFX's website includes a complete set of the Exchange's regulations and provides the public with access to various market data, including daily volume, open interest and settlement prices and monthly volume and open interest data. It also provides the public with access to historical data dating as far back as 1989.

<sup>14</sup> Accordingly, you request that the Commission not treat it as a change in the facts or circumstances represented in the No-action request if TFX opens such a representative office in the future as long as the operation of such an office is only for the purposes stated above. You represent that if TFX does open such an office, it will not be used to conduct trade matching or operate a clearing facility in the U.S.

as banks, securities companies, insurance companies, credit associations, futures brokers and foreign financial institutions.

## **B. Trading Members**

Legal entities wishing to become TFX trading members must apply for membership for each category of product traded, *i.e.*, an applicant must apply for membership to trade specific instruments or classes of instruments. For example, a separate admission as a trading member is required to trade Interest-Rate Financial Futures or Exchange FX Margin contracts. Trading member applicants must meet fitness and competence standards and are required to have substantial financial resources. Applicants for membership to trade interest rate futures are required to have at least ¥5billion<sup>15</sup> of net assets, a net assets-capital ratio of 100 percent or greater, and to expect to maintain stable profitability.<sup>16</sup> In addition, applicants must demonstrate their competence to act in the capacity of trading member by employing knowledgeable personnel and are currently required to have an office or branch within Japan.<sup>17</sup>

Further, the Financial Futures Trading Law sets forth various criteria that would disqualify an entity from becoming an exchange member. These statutory disqualifications include, among others: having been fined under the Financial Futures Trading Law or under analogous laws of foreign jurisdictions; having been expelled or having had trading rights rescinded under the law; having among its officers or principals a person that is not legally competent, a person who has filed for bankruptcy, a person who has been subject to imprisonment, a person fined under the Financial Futures Trading Law or a similar foreign statute; having had its license revoked under the Financial Futures Trading Law or an analogous law of a foreign jurisdiction; or having been expelled from membership.

In addition to the above requirements, trading members must meet certain operational requirements. For example, they must nominate responsible employees to be accountable for various vital functions, including the security and safekeeping of trading IDs and other trade security functions, the reporting of positions and the performance of various back-office and clearing-related business functions. Trading members must also be able to meet the requisite technical requirements to connect to the Exchange's trading system and their personnel must demonstrate competence by passing a Market Entry Test. Finally, trading members must report

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<sup>15</sup> As of February 14, 2007, ¥5billion=\$41,165,389.

<sup>16</sup> Applicants to trade interest rate futures must pay a trading registration fee of ¥50million (\$411,654).

<sup>17</sup> You represent that TFX will revise this requirement, in response to the Commission staff's granting of the no-action relief, in order to permit members from the U.S. to join TFX. When it adopts remote membership, TFX will consider other membership requirements for such remote members, such as minimum net asset levels. You represent that TFX undertakes through the No-action request to provide the Commission with notice of all material changes to its rules made subsequent to any grant by Commission staff of the no-action relief requested, including specifically, amendments to its rules permitting U.S. entities to become TFX members.

their financial condition to the Exchange periodically and are subject to inspection for continuing compliance with these various requirements by the Exchange's Office of Inspection.<sup>18</sup>

### **C. Clearing Members**

Clearing members must satisfy the criteria set forth in the TFX Clearing Regulations, which include the requirement that they possess at least one trading membership license and thereby meet the criteria described above.<sup>19</sup> Clearing member applicants must also demonstrate to the satisfaction of TFX that they have the requisite capability to undertake clearing operations for others. As discussed in greater detail below, clearing members must also make a contribution to the guaranty fund. The amount of this clearing deposit varies based upon the volume of contracts cleared by the clearing member but does not exceed ¥150million.<sup>20</sup>

## **III. OVERVIEW OF THE TFX TRADING SYSTEM**

At the outset, the Division notes that the description of TFX's trading system, LIFFE CONNECT™, set forth herein is based upon representations made by TFX or its representatives. The Division has not performed an independent assessment of the security or soundness of LIFFE CONNECT™ in connection with this request. Nonetheless, it should be noted that LIFFE CONNECT™, as the trading system used by NASDAQ LIFFE, was thoroughly examined by the Division and the Commission's Office of Information Resources Management in connection with NASDAQ LIFFE's application to become a DCM.<sup>21</sup> Furthermore, Commission staff undertook an examination of LIFFE CONNECT™ during its review of the e-cbot System in connection with the Chicago Board of Trade's October 31, 2003, self-certification to the Commission of a set of rule changes to replace its a/c/e electronic trading system with the e-cbot electronic trading system using LIFFE CONNECT™. Finally, Commission staff has previously described LIFFE CONNECT™ in connection with the granting of direct access no-action relief to LIFFE and Euronext Amsterdam<sup>22</sup> and described the e-cbot electronic trading system using LIFFE CONNECT™ in connection with the granting of no-action relief to the Winnipeg Commodity Exchange, Inc.<sup>23</sup>

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<sup>18</sup> Trading members must also pay per-contract Exchange fees based upon trading volume, a monthly Exchange fee of ¥50,000 (\$412), and a market entry deposit in the event of the member's default which, for a licensed financial futures broker, is ¥10million (\$82,331).

<sup>19</sup> In addition, Article 5 of the TFX Clearing Regulations requires, among other things, that the clearing member is a financial institution licensed under the Banking Law, the Securities and Exchange Law or is otherwise appropriately licensed, that it have knowledgeable personnel, that it have an office or branch office in Japan, and that it have adequate financial resources.

<sup>20</sup> As of February 14, 2007, ¥150million=\$1,234,962.

<sup>21</sup> The Commission approved NASDAQ LIFFE, LLC, a joint venture of the NASDAQ Stock Market and LIFFE, as a DCM on August 22, 2001. On July 24, 2003, NASDAQ LIFFE ended its relationship with NASDAQ and the DCM was renamed NQLX.

<sup>22</sup> CFTC Staff Letters No. 99-31 (July 23, 1999) and 05-16 (August 26, 2005) respectively.

<sup>23</sup> CFTC Staff Letter 04-35 (December 15, 2004).

## **A. Introduction**

In April 2003, TFX began using the LIFFE CONNECT™ trading system and, since then, TFX's trading system has operated using LIFFE CONNECT™ and API. As previously noted, LIFFE CONNECT™ is used by a number of other markets, including LIFFE, which introduced it on November 30, 1998 to replace LIFFE's floor-based market for individual equity option contracts. LIFFE subsequently enhanced the system to enable it to support trading in financial futures and equity index futures contracts. You represent that operation of LIFFE CONNECT™ by TFX is the same in all material respects as operation of the trading system on the LIFFE market.

TFX provides the central order processing facilities for its trading system, the "Trading Host," in Tokyo. It also provides the network and Application Program Interface, known as API, through which a member's front-end trading application communicates with the Trading Host. Members are required to supply their own workstations. They may use TFX trading application software, use front-end software supplied by an independent software vendor (ISV) or supply their own front-end trading application software. Members are able to link their workstations directly to other systems (*e.g.*, those dealing with trade capture and order management) to facilitate more efficient processing of business.

## **B. The Trading Host**

The Trading Host, which is validated using a process that requires, among other things, comprehensive business and technical testing before the system may be declared operational, provides the order matching service. Access to the Trading Host is limited to TFX members holding a relevant trading subscription which determines which contracts the member's traders may trade. In this way, TFX is able to provide a filter, and represents that it will do so, to preclude U.S. members from trading contracts from the U.S. that are not authorized to be traded in the U.S.<sup>24</sup> Non-members of TFX may not transmit orders directly to the Trading Host, and may transmit orders only using the AORS of a TFX member. The trading system requires that members providing or using an AORS must comply with certain order validation and recording requirements.

Orders processed by the Trading Host generally are for two price types: (i) limit orders<sup>25</sup> and (ii) market orders.<sup>26</sup> Market-on-open (MOO) orders are also permitted to be entered during the Pre-Open period and are executed at the calculated opening price.<sup>27</sup> Contingent multiple

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<sup>24</sup> Contracts not authorized to be traded in the U.S. include, *e.g.*, unapproved stock index contracts.

<sup>25</sup> Limit orders trade at the price stated in the order or better. Unfilled volume is maintained in the central order book until filled, withdrawn or cancelled.

<sup>26</sup> Market orders are executed consecutively at the best price available until all volume at that price has been traded and until all the order volume has been filled. Any unfilled volume from an incomplete market order is immediately cancelled.

<sup>27</sup> Unfilled volume converts to a limit order. If no bid or offer exists at market open, the MOO order is cancelled.

orders (CMO) are also permitted.<sup>28</sup> Order volume parameters may also be specified. Complete volume orders are executed only if there is sufficient volume available for them to execute fully. Minimum volume orders are cancelled if the minimum volume cannot be executed immediately. For limit orders, cancellation parameters also may be specified. Good Till Cancelled (GTC) orders are held until a specified date, the contract expires or they are withdrawn by the trader. Immediate and cancel orders are executed against any existing orders, and any unfilled portion of the order is immediately cancelled. The variables relating to resting orders may be modified, and orders may be withdrawn at any time prior to execution.

Orders on TFX are matched by price/time priority. As described in TFX rules, lower offers take precedence over higher offers and higher bids take precedence over lower bids. In the case of multiple bids or offers at the same price, earlier bids and offers take precedence over later bids and offers respectively. Thus, under price/time priority of marker orders, a bid (offer) is filled at the best price by the earliest entered offer (bid) at that price. If additional contract units are needed to fill the bid (offer), then the next oldest offer (bid) at that price is matched until all of the liquidity at that price has been exhausted. Then matches would commence at the next best price until the order is filled. TFX is also able to switch the algorithm to pro-rata. Under TFX's pro-rata algorithm, after the priority order<sup>29</sup> is fully allocated, unfilled order volume is allocated on a pro-rata basis against all resting orders at the best bid/offer. Fractional allocations are rounded down to the nearest integer for all allocations greater than one and rounded up to one for all fractional allocations less than one. For equally-sized fractional allocations, priority is granted to the oldest order. Remaining volume derived from the rounding process is allocated on a pro-rata basis.

The time assigned to an order is the time that it arrives at the Trading Host. The Trading Host calculates and adopts dynamic price limits throughout the trading day for each futures contract month and options series, and price limits may be updated by TFX market control officials. The Trading Host normally will reject attempts to enter orders for prices outside these limits. Following trade execution, traders are notified by the host that their orders have been executed and trade details automatically are input into the TFX clearing system.

### **C. The Trading Application**

The Trading Application is the application software that runs on members' workstations. As previously noted, members may develop their own trading application, purchase an application from an ISV or use the TFX trading application software. The Trading Application

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<sup>28</sup> CMO orders contain two or more component orders. Trading of any one component is contingent on being able to execute all component orders within the CMO. The CMO order is cancelled in its entirety, immediately and automatically, unless all of the designated components are matched. CMO orders enable intra- and inter-contract spread trading without legging risk because none of the related orders will execute if the criteria for any of the orders cannot be met.

<sup>29</sup> An order achieves status as the priority order if it improves the market with order volume equal to or greater than a stated minimum volume threshold. The unfilled portion of a partially filled priority order maintains its priority even if less than the minimum threshold.

communicates with the Trading Host through API software provided by TFX through its licensing agreement with regard to LIFFE CONNECT™.

#### **D. Distribution Network**

The TFX distribution network connects the Trading Host in Tokyo to its Japanese members. When TFX admits remote members, the distribution network will be expanded to connect members outside of Japan to the Trading Host. Hubs in major financial centers, including hubs located in the U.S., will connect to the Trading Host located in Japan. Orders from remote members arriving at the Trading Host from the new hubs, including those from members located in the U.S., will not be treated any differently or disadvantaged by the Trading Host from those of TFX's members located in Japan.

TFX will have two data centers, the main (live) and disaster recovery (back-up) sites. Dedicated local redundant lines in Japan will connect both the main site at TFX and the disaster recovery site and the network. To provide a connection point for members in the U.S., TFX will place U.S. access points (Point of presence or Pop) and connect the Exchange and U.S. Pop via the network. Another dedicated local line in the U.S. will be used to connect U.S. members and U.S. Pop.

#### **E. Audit Trail**

The TFX trading system captures a complete audit trail of all orders entered into the trading system and all trades that are executed. In this regard, the following information is required to be included on orders submitted to the trading system: (i) commodity; (ii) contract month; (iii) purchase or sale; (iv) account identifier (proprietary or customer); (v) quantity; (vi) limit price (except for market orders, MOO orders and other similar order types); and (vii) strike prices, put or call (for options). The trading system automatically records the time of, and retains a record of, each entry into the system, including the entry and withdrawal of resting orders that have not resulted in an executed trade. Thus, the trading system captures and retains a complete and accurate audit trail of all activity on the trading system. All relevant data are retained in perpetuity and audit trail records are maintained in an electronic storage medium.

Confirmations of orders successfully entered into the trading system are automatically generated and sent to members as are confirmations with respect to all matched trades. These confirmations are also captured automatically and retained as part of the permanent audit trail.

#### **F. Data Dissemination**

TFX disseminates trading data (prices/quotes) to members via the trading system and more generally through third party vendors, such as Bloomberg and Reuters. The trading system also makes available to TFX members a summary of the member's activity during that session, including the member's orders entered during the current trading session and completed trades. Additional information, such as daily high, low, open interest and volume, is distributed publicly by TFX. Such information is also available in an archived form on TFX's website.

### **G. System Reliability**

The reliability of the Trading Host server is grounded in the hardware specifications. As necessary, the Trading Host can control the number of messages received per second and the log on status from the API. Thus, the trading system is able to make necessary adjustments to remain operational in the face of varying computational demands. The TFX trading system is operated to strict service levels and has demonstrated its reliability since its deployment. The LIFFE CONNECT™ system has been designed to exacting specifications and has been in use by TFX for over three years. During that period, the TFX trading system has been operated with a Trading Host availability of 100 percent.

### **H. System Security**

The trading system includes a security system that provides for authentication and confidentiality and ensures the integrity by using features embedded in the API that cannot be accessed externally. The security system is responsible for: (i) maintaining the database of currently certified users; (ii) authenticating certified users as they log on; (iii) distributing session keys as part of the login process; and (iv) maintaining a list of currently logged-on trading applications. All entities using the TFX's LIFFE CONNECT™ trading system must first log in to the security system. Encryption is used for user security login and for user authentication, and ensures that the sender cannot be identified by entities outside of the system. Communication is permitted only between the Trading Host and the trading applications.

Each member must implement suitable security measures to ensure that only those persons specifically authorized by the member to trade have access to passwords and security keys. Each member has an ID Administrator who is responsible for managing access to the trading system and who is required to submit a form to TFX for each trader that the member wishes to register with the Exchange and thereby be granted direct access to the trading system. The form, which must be signed by ID Administrator, includes, among other things, details of the ID Administrator and the number and type of trading access rights granted. Once a trader has been registered by TFX, the access keys and passwords are made available to the ID Administrator via a website.

Each member has a member's CONNECT Administrator (MCA), who is responsible for the competence and suitability of the member's traders and must have the authority to adjust or withdraw any orders submitted by them. The MCA also must ensure, as far as possible, that all business thus conducted is in accordance with TFX Rules and must know and be willing to disclose to TFX the immediate source of all orders.

### **I. Disaster Recovery**

With respect to disaster recovery, TFX currently makes and updates operational and system back-up data every second day and saves that data in a building that is geographically separate from TFX. Operational data includes databases with respect to the Trading Host, Archives Server, Clearing Server, and Market Configuration Server. System data includes OS

and Operational applications. Back up of the data is made via magnetic tape recording process. TFX will maintain two data centers, one at the main site and the other at the geographically-separate disaster recovery site. Both centers are able to execute all the necessary services for operation of the market. Data is streamed from the live center to the backup center at a regular interval and a switch-over between the two centers at any time is possible.

TFX has established general policies to respond to incidents affecting operation of the trading system. These policies constitute the trading system's support line and respond to possible operational problems by assigning responsibility to address various issues and by establishing well-understood escalation policies. These are divided into first-, second- and third-line functions and responsibilities. TFX takes charge of the first-line response. When an incident or problem is detected, TFX initiates administrative action and administers the incident until closed. Fujitsu, the network and clearing systems provider, takes charge of the second-line response. Fujitsu monitors system status and reports to TFX when an incident is detected, starts the investigation to identify the root cause and, with TFX's approval, takes measures to solve the problem. LIFFE has the responsibility to address third-line functions. LIFFE provides expert support to cope with and address identified problems and problematic circumstances arising in connection with operation of LIFFE CONNECT™.

TFX has in place a business continuity plan which would enable the Exchange to implement recovery procedures in the face of a disaster. This plan stresses the ability of TFX to resume operations within a commercially acceptable time frame. This plan is continually reviewed and updated. In addition, TFX periodically conducts disaster recovery tests to evaluate the adequacy of its procedures and contingency planning.

## **J. Adherence to IOSCO Principles**

TFX represents that the Exchange has adhered to, and will continue to adhere to, the Principles for the Oversight of Screen-Based Trading Systems for Derivative Products developed by the Technical Committee of the International Organization of Securities Commissions (IOSCO Principles)<sup>30</sup> and adopted by the Commission on November 21, 1990.<sup>31</sup> In this regard, TFX has licensed the LIFFE CONNECT™ trading system, which Commission staff previously

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<sup>30</sup> Japan was one of eight jurisdictions that participated in Working Party 7 of IOSCO (Working Party), whose mandate included, among other things, the identification of issues related to screen-based trading systems for derivative products. In considering the special concerns for screen-based trading systems, the Working Party identified and addressed the following issues: transparency, order execution algorithms, operational issues, security and system vulnerability, access, financial integrity, disclosure, and the role of system providers. The Working Party considered these issues and articulated for each a broad principle to assist regulatory authorities in overseeing screen-based trading systems. The IOSCO Principles were adopted by IOSCO on November 15, 1990 and set out in broad terms the international consensus as to the regulatory considerations to be addressed in reviewing mechanisms for cross-border screen-based trading.

<sup>31</sup> The Commission adopted the IOSCO Principles as a statement of regulatory policy for the oversight of screen-based trading systems for derivative products. "Policy Statement Concerning the Oversight of Screen-Based Trading Systems," 55 Fed. Reg. 48670 (Nov. 21, 1990).

has found to comply with the IOSCO Principles.<sup>32</sup> Moreover, TFX represents that in adapting LIFFE CONNECT™ as the TFX trading system it has employed the expertise of industry specialists to ensure that the resulting system infrastructure follows best industry practice and quality standards. TFX represents that the Exchange has satisfied the FSA, which has endorsed the IOSCO Principles, that TFX satisfies the IOSCO Principles in connection with its operation of the TFX trading system.

#### **IV. SETTLEMENT AND CLEARING**

##### **A. Introduction**

TFX is a financial futures clearing facility pursuant to the Financial Futures Trading Law and operates as the clearing house for the Exchange. As such, TFX is the universal counterparty to all transactions on the Exchange and provides a guarantee against counterparty credit risk. To provide credit support, it operates a margining system under which each party to a contract deposits a good faith performance bond to assure that the party will fulfill its obligations under the contract. This margining system requires that original margin be deposited and that positions be marked-to-market on a daily basis in order to maintain required minimum margin levels. Moreover, customers are protected through the segregation of their funds from the proprietary funds of TFX members. In addition, TFX maintains a guaranty fund that, as of December 31, 2006, contained ¥9.9 billion.<sup>33</sup> You represent that TFX provides for procedures, comparable to those used by U.S. contract markets, to ensure the financial integrity of transactions entered into through its facilities.

##### **B. Systems**

Fujitsu provides the TFX Clearing Host, located in Tokyo, and other related clearing and data processing systems. Clearing data are transmitted via a dedicated network which meets hardware specifications similar to those met by the LIFFE CONNECT™ system. Trading data from the TFX trading system are uploaded automatically into the TFX Clearing Host. Certain clearing-related information can be included with submission of an order. Accordingly, TFX members, as a Trading Host function, can designate trade give-ups/take-ups and designate position open/off-set instructions by account by means of including relevant information in an order. Such clearing-relating instructions are automatically transmitted from the Trading Host to the Clearing Host upon trade execution and subsequently will be transmitted to the designated clearing member. This automated process will assist clearing members in Japan with respect to clearing positions for their remote trading members. TFX provides a browser-based application tool known as “TFX Clearing Web.”

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<sup>32</sup> See CFTC Staff Letters No. 99-31 (July 23, 1999) and 05-16 (August 26, 2005). The Financial Services Authority of the United Kingdom, LIFFE’s regulatory authority, also has examined LIFFE CONNECT™, in connection with its oversight of LIFFE as a Recognized Investment Exchange, to determine that it complies with the IOSCO Principles.

<sup>33</sup> As of February 14, 2007, ¥9.9billion=\$81,507,470.

### **C. Clearing and Settlement Procedures**

The clearing process is initiated by the trading system's automatic entry into the clearing system of details of an executed trade. As discussed in greater detail below, certain position-related functions, such as open/close or give-up/take-up instructions, can also be entered by members through the clearing system.<sup>34</sup> In addition to access to information via TFX Clearing Web, TFX members in Japan (both clearing and non-clearing members) can access the clearing system and provide and receive necessary information through an interface of clearing operations provided by TFX. Non-clearing members that are located outside of Japan will be able to obtain relevant clearing information and services through their Japanese clearing members.<sup>35</sup> As a convenience for members' internal clearing operations, trades executed during the evening trading session, which begins at 3:30 p.m. Tokyo time, are cleared on the next trade day. A daily settlement price is calculated by the TFX market surveillance group immediately after the end of the day session and members are so notified.

Either at the time of order submission to the trading system or later during the clearing process, traders must provide instructions with respect to whether newly established positions should off-set previously established positions. Instructions not to off-set will result in maintenance of both open positions by the trader until the last trading day for final settlement. The volume of positions that are maintained as open interest, or long/short position(s), is taken into consideration in margin calculations. Instructions may be given on a per trade basis or at once for all trades in an account.

The TFX clearing system requires that all accounts be designated as either a house or customer account and orders submitted to the trading system are required to include the account-type designation. This information is then automatically transferred from the trading to the clearing system. In addition, members may include a number of optional account designations beneath the house/customer account designations, including designating sub-accounts by customer and by strategy-type (hedge, non-hedge). This assists in account management with respect to trading, positions and margins.

The TFX clearing system also accommodates give-up/take-up relationships. Give-ups can be designated at the time of order entry through the trading system or, after trade execution, through the clearing system. Upon designation that a trade is to be given-up, the clearing member must accept the trade subject to prior terms and conditions agreed upon. Give-up relationships can be registered on TFX's clearing system so that trades are given-up. Give-up

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<sup>34</sup> Clearing operations which require updating of Clearing Host data, such as give-ups and reporting of position status, are allowed only during clearing operational hours, which are from 8:30 a.m. to 6:30 p.m. Tokyo time. However, clearing and back-office operations which do not require updating of Clearing Host data, such as displaying pages and extracting transaction data in PDF and CSV file format, are possible throughout the clearing system's on-line hours of 8:00 a.m. to 10:00 p.m. Tokyo time.

<sup>35</sup> Remote members, if they so wish, will be able to develop their own systems interface for clearing operations.

relationships require that an agreement be entered into among the customer, the broker giving-up a trade and the broker taking-up the trade.<sup>36</sup>

#### **D. Risk Management and Margining Systems**

TFX has developed and implemented procedures to measure the risk parameters of the products listed for trading on the Exchange. Exchange staff also monitors price trends in the futures and the underlying cash markets, monitors price volatility and conducts simulations of the affect of these risks on accounts carried by members. Using these risk management procedures and analyses, TFX determines the appropriate level of margins which should be required and whether extraordinary intra-day margin calls are appropriate. Margin is required to guarantee fulfillment of obligations associated with contracts executed on the Exchange and TFX requires that such margin be deposited with the Exchange when a position is opened. Thereafter, TFX marks such positions to market on a daily basis using a daily settlement price which, as noted above, is calculated by the TFX Market Surveillance Group immediately after the end of day session. Generally, variation margin is due the following day.

In addition to the routine collection and payment of variation margin, TFX may, as circumstances warrant, require that additional amounts of margin be deposited on an intra-day basis. Generally, members will be notified of intra-day margin calls by notice posted to the trading and clearing screens, generally around 11:30 a.m. Tokyo time. Margins are calculated using SPAN® methodology. Apart from the collection of funds as Exchange margin, members may require customers to post additional margin to cover unrealized losses in the customers' accounts.

#### **E. Segregation of Customer Funds**

Beginning in 1998, TFX members have been required to segregate customer funds from their proprietary funds, so a TFX member must segregate margin for customers' positions from the margins supporting its proprietary positions. TFX Regulations for Margin and Unsettled Financial Futures Contracts provides that a trading member receiving Exchange margin from a customer shall deposit the margin with the Exchange as agent for its customer. Thus, customer margins are not held by a member, but rather are held by TFX directly in what is known as "direct deposit" of customer margin. An intermediate broker may deposit its own property with the Exchange as agent for its customer, known as "replacement deposit," if the customer has so agreed. Such separate deposits are maintained by TFX as funds arising from separate origins. Funds on deposit covering positions in one category may not be used by the Exchange to cover shortfalls in another deposit category.<sup>37</sup>

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<sup>36</sup> TFX accepts give-up agreements entered into for trading on another exchange as valid with respect to positions on TFX. TFX also accepts as valid the International Uniform Brokerage Execution Service (Give-up) Agreement prepared by the Futures Industry Association.

<sup>37</sup> As a means to meet its self-regulatory obligations, TFX requires that members file reports with the Exchange, including statements relating to the amount of outstanding margins supporting customers' accounts. TFX's Member Firm Inspection Office conducts inspections of members' account books to verify the status of deposited margins,

Segregation of customer funds is required to be provided by all Japanese brokers to their customers. Accordingly, any customer placing orders directly with a financial futures broker located in Japan will be covered by the segregation requirements. Non-Japanese customers carrying their positions through non-Japanese brokers are accorded the protections provided under the laws of their home country which govern the customer/broker relationship.<sup>38</sup>

#### **F. Default remedies and procedures**

In order to cover losses in the unlikely event of a clearing member default, TFX maintains a default compensation reserve financed from Exchange profits as well as a guaranty fund financed through deposits made by clearing members.<sup>39</sup> All members are required to make a market entry deposit upon becoming a TFX member. Clearing members are further required to contribute to the guaranty fund (clearing deposit) by an amount that varies according to the clearing member's aggregate traded volume during the previous six-month period.

TFX has the following lines of defense to address the unlikely event of a clearing member default. First, TFX would have recourse to any amounts on deposit by the defaulting clearing member. Pursuant to the TFX Clearing Regulations, TFX would cover the uncompensated portion of such losses that remained in the following order: (i) TFX default compensation reserve; (ii) the guaranty fund; and (iii) extraordinary clearing deposits called from clearing members. A call for additional clearing deposits would require that clearing members contribute the additional amounts in proportion to their then current contribution.

### **V. OVERVIEW OF THE REGULATORY STRUCTURE IN JAPAN**

#### **A. Introduction**

TFX and its members are subject to a comprehensive regulatory regime. This regime provides for financial, fitness and competency requirements for Exchange members and other industry participants; reporting and recordkeeping requirements; procedures governing the treatment of customer funds and property; sales practice and other conduct of business standards; measures designed to protect the integrity of the markets; and statutory prohibitions on fraud, customer abuse and market manipulation.

The regulatory framework is established by the Financial Futures Trading Law, is based upon the concept of exchange self-regulation,<sup>40</sup> and is supplemented by the Financial Futures

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whether customer margins are properly segregated, and to confirm that all margins are properly accounted for, managed and preserved.

<sup>38</sup> U.S. customers trading through a U.S. FCM would therefore be recognized as being covered under the CFTC's secured amount requirements.

<sup>39</sup> As of the end of 2006, the default compensation reserve stood at ¥164million (\$1,350,225). As previously noted, the guaranty fund, as of March 31, 2006, contained ¥9.9 billion (\$81,507,470).

<sup>40</sup> As discussed below, Japan has adopted a new statute governing financial instruments. This will become effective with respect to the trading of financial futures contracts in the summer of 2007. You represent that the new law, The Financial Instruments and Exchange Law, generally unifies regulation of financial instruments and

Trading Law Enforcement Regulations and by Orders of the Office of the Prime Minister. In broadest terms, the regulatory framework requires that financial futures exchanges, such as TFX, be authorized to engage in business subject to initial and continuing compliance with regulatory requirements. Trading of financial futures other than on an exchange that has applied for and been so approved by the Prime Minister is prohibited. The conditions for approval as a financial futures exchange include requirements relating to governance of the exchange, criteria for admission of members, financial soundness of members, prudential financial requirements for members and market participants, sales practice and conduct of business standards, and practices and measures to protect market integrity.

In order to be approved, the exchange's trading rules and the customer service contracts (or Financial Futures Brokerage Terms) that it requires of its members must conform with the law and the enforcement regulations and Cabinet Orders thereunder, and must be sufficient for achieving the fair and smooth operation of the exchange and for the protection of customers. In addition, the exchange must demonstrate that it has sufficient resources to manage properly its operations as an exchange; that it has a sufficient number of members so that it is anticipated that its operations will be fair and smooth; and that its operation is necessary and appropriate to the public interest and to the protection of customers. Moreover, the officers of the exchange must demonstrate that they are fit for the position. Finally, approval of a financial futures exchange to operate requires that the exchange may not have a prior approval cancelled or be subject to cancellation due to a violation of any other provision.<sup>41</sup>

## **B. Exchange supervision**

Under the Financial Futures Trading Law, the Prime Minister is responsible for exercising supervisory authority over TFX. Among other things, the Prime Minister is authorized to grant licenses to financial futures exchanges and to approve these exchanges' Articles of Incorporation, Trading Regulations (Business Regulations), and Brokerage Agreement Standards (or Financial Futures Brokerage Terms), and their financial futures contracts. The Prime Minister has delegated these powers, other than the authority to grant licenses to financial futures exchanges, to the Commissioner of the FSA under the Financial Futures Trading Law. The FSA, established in July 2000 as a result of the merger of the Financial Supervisory Agency<sup>42</sup> and the Financial System Planning Bureau of the Ministry of Finance, has a staff of 1340 and is largely organized into five major components: the Planning

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strengthens certain aspects of the current law but that the over-all regulatory structure with respect to regulation of TFX will remain the same as it is currently.

<sup>41</sup> The Financial Futures Trading Law further sets forth requirements with respect to governance and the organization of a demutualized exchange, such as TFX, providing that shareholders with greater than a 20% interest in the exchange must obtain the approval of the Prime Minister. Such "major shareholders" are subject to on-site inspections, to inspections of their books and records, and are required to provide reports and information regarding their business and operations. No TFX shareholders currently exceed a ten per cent ownership interest in the Exchange.

<sup>42</sup> The Financial Supervisory Agency was established in 1998 as an administrative and external organ of the Prime Minister's Office and was responsible for the inspection and supervision of private-sector financial institutions and surveillance of securities transactions.

and Coordination Bureau, the Inspection Bureau, the Supervisory Bureau, the Securities and Exchange Surveillance Commission (SESC) and the Certified Public Accountants and Auditing Oversight Board. The FSA is led by a Commissioner and has broad supervisory responsibility for all aspects of financial services, including inspection, supervision and surveillance of financial activities, and for planning with respect to the financial system.

Specifically, the FSA is responsible for ensuring the stability of the financial system in Japan; protection of depositors, insurance policyholders and securities investors; planning and policymaking concerning the financial system; inspection and supervision of private-sector financial institutions; and inspection, supervision and surveillance of securities and financial futures exchanges. In addition, the FSA has responsibility with respect to the establishment of rules for trading in securities and financial futures markets; the establishment of business accounting standards; supervision of certified public accountants and audit firms; and participation in the activities of international organizations and international regulatory cooperation. As noted above, the FSA operates through a structure of industry self-regulation and a framework of transparent and clear rules.

Within the FSA, the SESC is responsible for oversight of the securities and financial futures markets and for overseeing those markets' compliance with statutory mandates. The SESC has a staff of 564 and is directed by a Chairman and two Commissioners appointed by the Prime Minister. It conducts daily market surveillance of trading on the exchanges, compliance inspections of market intermediaries, examinations of disclosure documents, and investigations of acts suspected to have compromised the fairness of securities and financial futures trading and of other types of violations. Where an investigation warrants, the SESC may recommend that the Commissioner of the FSA take administrative action to impose a civil money penalty. In cases where an investigation uncovers a possible criminal offense, the FSA may file a formal complaint with the public prosecutors. The SESC also makes policy proposals to the Commissioner of the FSA.

### **C. Requirements applicable to exchange operations**

Exchanges are required by statute to include certain provisions within their rules. These relate to qualifications of members; the safekeeping and handling of trust money; the requirement, collection and safekeeping of margin funds; the terms and conditions for financial futures transactions and options contracts; listing and de-listing of contracts; suspension of trading; matters relating to settlement and delivery, matters relating to trading restrictions, and any other provisions that may apply to trading in such contracts on the exchange.<sup>43</sup>

The Financial Futures Trading Law prohibits abusive trading activities. These include the prohibition against engaging in fictitious transactions, pre-arrangement of trades, acting

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<sup>43</sup> The Prime Minister has statutory authority to restrict the trading of, or the acceptance of, orders by members for trading on the exchange if an excessive number of transactions are conducted or are likely to be conducted, or an unreasonable market price is formed or is likely to be formed on the exchange and such restriction is necessary to maintain order on such financial futures market and in the public interest or to protect customers.

individually or in concert to give a false impression of market activity or price fluctuations (manipulation of prices), false dissemination of information relating to market activity or prices, and bucketing customer orders. As discussed above, customer margin funds must be held in segregation, thus establishing statutory protection of customer funds. Member conduct with respect to customers is also addressed under the Financial Futures Trading Law. Specifically, the exchange must promulgate rules detailing various items of the customer service agreement, *i.e.*, customer service contracts (or Financial Futures Brokerage Terms) must include conditions for acceptance of orders, methods of settlement, provide rates and deposit methods for customer's margin and other matters required for the acceptance of orders.

Exchanges must file periodic reports listing contract volume, reports on governing functions, major activities, activities as a self-regulatory organization, changes in exchange participants, adoption of and change in exchange rules, finances, profit and loss, financial statements and information relating to affiliates. In addition, the exchange is required to report to the Prime Minister regarding non-routine events, such as if the exchange temporarily closes, suspends, or cancels trading in whole or in part and when trading re-commences after a suspension. Moreover, the exchange must report to the Prime Minister without delay if the number of open transactions for the house account of a member exceeds levels specified by the Financial Futures Trading Law. The exchange is also required to publish information relating to total trading volume, daily high, low and last prices and trade value separately for each contract on a daily basis and in the manner provided by the Financial Futures Trading Law.

These regulatory requirements apply to the exchange on a continuing basis. Accordingly, pursuant to the Prime Minister's supervisory authority, the Prime Minister may, upon finding violations by the exchange, cancel its approval to operate. The Prime Minister also may suspend the exchange's operation and business upon a finding that the exchange harms the public interest or fails to protect customers. The Prime Minister may also order the exchange to remove officers found to have violated the law or to have become officers through fraudulent means and order the exchange to expel a member that has violated the law. The Prime Minister, as an exercise of supervisory authority, may as deemed necessary and appropriate, in the public interest, and to protect customers, order the exchange to amend its Articles of Incorporation, trading rules, customer service contract rules (or Financial Futures Brokerage Terms), other rules, trading practices, change management or to take such other measures as the Prime Minister determines are necessary. Finally, the Prime Minister may order the exchange to make reports or provide information regarding its business, operation or property, regarding the business operation or property of its members, or authorize government officials to enter the premises and conduct searches on site. These searches include searches of the exchange facilities and those of its members, as well as the subsidiaries of the exchange or its members.<sup>44</sup>

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<sup>44</sup> The Financial Futures Trading Law also includes within its framework regulation of market intermediaries. The regulatory regime requires that persons conducting a financial futures business register with the Prime Minister, and includes requirements with respect to advertisement, prohibitions on false or misleading advertisements, the requirement that a Customer Agreement be provided, required delivery to customers of various reports or statements, prohibitions on self-dealing, prohibitions on various abusive sales and trading practices, and the requirement that financial futures businesses act in a "faithful and fair" manner with customers. In addition, financial futures businesses are required to ascertain that trading in financial futures is appropriate for the customer

#### **D. Recent Amendments to regulatory statutes**

You represent that Japan is currently amending many of the laws governing its financial services sector, including the laws which apply to financial futures trading. In particular, the Financial Futures Trading Law is to be superseded by the Financial Instruments and Exchange Law, a new statute which applies more broadly to a number of different types of securities, futures and derivatives instruments. The new statute will go into effect during the summer of 2007.

You represent that the overall intent of the new legislation is to strengthen and enhance financial service regulation, to bring greater uniformity to the regulations that apply to various financial instruments, to enhance the independence of self-regulatory functions of exchanges and to close loopholes which may exist among regulatory frameworks that apply to each separate type of financial instrument. This will help ensure that the rules are the same for various financial instruments having the same or similar economic functions and permit a greater degree of financial innovation and the development of new financial instruments that go beyond existing business lines. The legislation accomplishes this goal by applying a uniform set of rules to a variety of instruments that are currently regarded under the law as “securities.” Generally, as summarized by FSA, the goals of the legislation are to enhance user protections, enhance users’ convenience and to ensure development of an industry infrastructure that compares favorably to those of other major industrialized nations. The new structure introduces to Japanese financial regulation different rules depending upon the characteristics of the financial instruments and the knowledge and experience of the investor.<sup>45</sup>

To the extent that the new law will affect the regulation of exchanges, you represent that its effect will be to strengthen and enhance the existing regulatory framework. For example, when implemented, the Financial Instruments and Exchange Law will permit all financial instruments exchanges to establish an independent self-regulatory committee within the organization. The new law will also increase penalties for violations and expand the scope of penalties for entering orders with the intention of canceling them for the purpose of market manipulation. Under the enhanced penalties, customers will be subject to both civil monetary and criminal penalties for such behavior and financial instruments firms will be subject to increased civil and criminal penalties. For example, violations such as unfair trading, spreading of rumors, resorting to deceptive devices, or market manipulation are currently subject to penalties of five years imprisonment or fines for an individual of ¥5 million<sup>46</sup> or for a corporation

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in light of the customer’s knowledge, experience and financial condition. Financial futures businesses are also required to keep books and records regarding their businesses, to keep a reserve against liabilities, and to maintain a required level of capital.

<sup>45</sup> Following implementation of the new Financial Instruments and Exchange Law, the same rules of conduct will apply to the intermediation of financial futures and derivatives. Under the new law, the regulation of the solicitation and sale of financial futures will move from its own discrete set of regulations to a broader rule book which applies generally to all financial instrument firms. Accordingly, many of the law’s revisions are targeted chiefly to disclosure requirements and to requirements relating to the offer and solicitation of financial instruments to investors.

<sup>46</sup> As of February 14, 2007, ¥5million=\$41,165.

of ¥500 million.<sup>47</sup> These fines will be increased under the new law to 10 years imprisonment or ¥10 million<sup>48</sup> civil money penalties for individuals and ¥700 million<sup>49</sup> for corporations.

## **VI. TFX STATUS AS AN SRO**

The Financial Futures Trading Law provides that a financial futures exchange must require under its Articles of Incorporation that members comply with the Law, Orders and administrative rules issued thereunder, with the rules of the exchange, and with just and equitable principles of trade. Thus TFX, as a condition of continued approval to operate as a financial futures exchange, operates self-regulatory supervisory programs designed to ensure that its members comply. The Prime Minister may cancel such approval to operate upon a finding that TFX fails to enforce these obligations. The Prime Minister's supervisory authority is carried out by the FSA, which conducts oversight supervision of TFX to ensure that it meets its self-regulatory obligations. You represent that TFX maintains records of its self-regulatory activities and FSA reviews the operation of TFX's self-regulatory programs to ensure that TFX fulfills its statutory responsibilities.

You represent that TFX fulfills its self-regulatory responsibilities in a manner comparable to the operations of a U.S. DCM. As a general requirement, TFX is required to operate in a "fair and smooth" manner and to contribute to the protection of customers. It has a comprehensive rule book, which governs members' conduct with respect to both trading on the Exchange and to sales and financial conduct in relation to their customers. These rules include, among other requirements, that members: be fit, not have any statutory disqualifications, provide customers with disclosure information, maintain customer funds in segregation, have adequate capital, provide customers with confirmations, not abuse customer orders or manipulate the market, and provide the Exchange with requested information. In addition to the specific requirements contained in Exchange rules, TFX also has a general requirement that its members follow just and equitable principles of trade.

TFX staff monitors to ensure that members comply with these rules and requirements and is empowered to bring remedial actions to address any breach of these requirements by members. Pursuant to the Financial Futures Trading Law, the Exchange is authorized to levy fines, to suspend or to restrict members or to expel members for violation of any of the conditions of membership, including the condition that members comply with the TFX rules and applicable law. The Inspection Office is responsible generally for conducting inspections of members to ensure compliance with Exchange rules and other requirements, and is also responsible for operating the Disciplinary Committee system that addresses violations by members of Exchange rules or other requirements. The Administration Office also has a role in rule enforcement in that it deals with membership applications and the entry and withdrawal of members.

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<sup>47</sup> As of February 14, 2007, ¥500million=\$4,116,539.

<sup>48</sup> As of February 14, 2007, ¥10million=\$82,331.

<sup>49</sup> As of February 14, 2007, ¥700million=\$5,763,154.

In addition, as briefly noted above, component parts of the Business Operation Department, the Administration Office and the Operation Office are engaged in oversight of market and member activities. The Business Department includes the Market Surveillance Group and the Clearing and Settlement Group. The Market Surveillance Group, as its name denotes, conducts oversight and surveillance of trading on TFX. The Market Surveillance Group conducts surveillance of the market by analyzing various futures and cash market data, including price data, and by comparing current futures market data to the price levels across commodities, across time and across geographic markets. The Exchange has the authority to impose prophylactic limits on the size of member positions if it deems such limits to be necessary.

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The Market Surveillance Group also conducts surveillance to detect possible abusive trading by members, such as engaging in fictitious transactions, prearranging trades, acting individually or in concert to give a false impression of market activity and false dissemination of information by analyzing various futures market data, including in particular unusual trading patterns or other indicators of suspicious activity. In this regard, surveillance staff will open an inquiry when suspicious trades or trading patterns have been identified through various electronically generated exception reports. The staff has authority to make such inquiries of members regarding any suspicious activities and may make such further investigation as is warranted.<sup>51</sup> The Clearing and Settlement Group is responsible for clearing operations and for monitoring risk, conducting risk assessment, and other related clearing functions. In the event that a member's position is deemed to pose an unacceptable risk to the clearinghouse, TFX has the authority to take any necessary measures including, among other things, suspending the member's trading, closing the member's open position and requiring the posting of additional margin.

## **VII. INFORMATION-SHARING**

As described more fully below, the Commission and its staff will be entitled to receive sufficient information regarding TFX, the trading system and TFX's market participants directly from TFX pursuant to the terms and conditions of the no-action relief granted herein and existing information-sharing agreements. TFX is a signatory to the companion memorandum to the Declaration on Cooperation and Supervision of International Futures Markets and Clearing Organizations, as amended March 1998 (commonly referred to as the Boca Declaration). As such, TFX supports the sharing of relevant information between certain derivatives exchanges and clearing organizations in order to combat potential hazards to the stability, safety and soundness of the international financial markets. Moreover, TFX in its No-action request, undertakes to provide the Commission, upon request, sufficient information regarding the Exchange and its members operating pursuant to the requested no-action relief to: (i) evaluate

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<sup>50</sup> You represent that to date, TFX has not found it necessary to impose such limits with respect to trading in these cash-settled, financial futures contracts and that the Euroyen contracts are based upon very liquid and deep cash markets.

<sup>51</sup> As noted above, the trading system captures a comprehensive audit trail of order information and executed trades. This provides the foundation, along with other documentary evidence, for conducting initial inquiries and inspections. TFX keeps such audit trail information archived permanently.

the continued eligibility of TFX or its members for the relief; (ii) enforce compliance with the terms and conditions of the relief; and (iii) enable the Commission to carry out its duties under the Act and Commission regulations.

With respect to government to government information sharing, you represent that the Japanese regulatory authorities have been leaders in efforts at international cooperation and information sharing with respect to the regulation of futures markets. Specifically, the Securities Bureau of the Ministry of Finance was one of the original signatories to the Windsor Declaration of 1995 and the Ministry of International Trade and Industries and the Ministry of Agriculture, Forestry and Fisheries were sponsors and signatories of the Tokyo Communiqué of 1997. Further, the FSA adheres to the IOSCO Objectives and Principles of Securities Regulation of 1998.<sup>52</sup>

In addition, the FSA is a joint signatory with the Commission and the U.S. Securities and Exchange Commission (SEC) of a Statement of Intent (SOI) Concerning Cooperation, Consultation and the Exchange of Information dated May 17, 2002 and amended January 16, 2006. The SOI establishes a framework for information sharing and facilitates cooperation in cross-border investigations of potential violations of securities and futures laws. The SOI is supported by diplomatic Notes Verbale (Notes), exchanged by the governments of the U.S. and Japan. The Notes state the views shared by the two governments concerning the cooperation that the SEC, the CFTC and the FSA intend to provide under the SOI with respect to the way that information obtained under the SOI can be used by each country's criminal authorities. By letter dated February 15, 2007, the FSA confirmed that the SOI, as amended, would extend to information requested by the Commission in connection with trades and activities by members of TFX under any no-action relief granted by the CFTC, or any division thereof, with regard to the placement in the U.S. of electronic facilities providing access to TFX.<sup>53</sup>

## **VIII. CONCLUSION**

Consistent with the Commission's Policy Statement and the June 2 Order, the Division has reviewed and considered TFX's No-action request and the information and documentation forwarded to the Division in support thereof. Among other things, the materials furnished by TFX indicate that TFX and its members are subject to oversight in Japan by a regulatory regime that is based upon regulatory objectives that generally are equivalent to those in the U.S.; that the regulatory regime provides basic protections for customers trading on TFX's market and for the integrity of the market itself; that TFX and its regulatory authority employ surveillance, compliance and enforcement mechanisms designed to ensure compliance with statutes and TFX's and the regulatory authority's rules and regulations; that TFX adheres to the IOSCO Principles; and that adequate information-sharing arrangements applicable to the activities of

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<sup>52</sup> In May 2006, Japan submitted an application to sign the IOSCO Multilateral Memorandum of Understanding Concerning Consultation and Cooperation and the Exchange of Information (MMOU) adopted at the IOSCO Annual Conference in May 2002.

<sup>53</sup> Letter from Toshitake Kurosawa, Director for International Financial Markets, FSA, to Richard Shilts, Director, Division of Market Oversight, Commodity Futures Trading Commission (February 15, 2007).

TFX are in place.<sup>54</sup>

Based specifically upon these and other representations made by TFX in support of its No-action request, the Division has determined that granting no-action relief to TFX and its members would not be contrary to the public interest. Accordingly, subject to compliance with the terms and conditions stated herein, the Division will not recommend that the Commission institute enforcement action against TFX or its members solely based upon TFX's failure to obtain contract market designation or DTEF registration pursuant to Sections 5 or 5a, respectively, of the CEA if: (1) TFX members trade for their own accounts through the trading system in the U.S.; (2) TFX members who are registered with the CFTC as FCMs or who are Rule 30.10 Firms submit orders for U.S. customers to the trading system for execution; (3) TFX members who are registered with the CFTC as CPOs or CTAs, or who are exempt from such CPO or CTA registration pursuant to Commission Regulation 4.13 or 4.14, submit orders on behalf of U.S. pools they operate or U.S. customer accounts for which they have discretionary authority, respectively, provided that an FCM or Rule 30.10 Firm acts as clearing firm and guarantees without limitation all such trades of the CPO or CTA effected through submission of orders on the trading system; and (4) TFX members who are registered with the CFTC as FCMs or who are Rule 30.10 Firms accept orders for U.S. customers transmitted via AORS for submission to the trading system.

The Division's no-action position shall become effective immediately with respect to the following TFX contracts:

- Three-month Euroyen Futures, and
- Three-month Euroyen Options

If additional futures and option contracts become available for trading through the trading system, TFX may make such futures and option contracts available for trading on LIFFE CONNECT™ from the U.S. in accordance with the provisions of the Commission's Notice of Revision of Commission Policy Regarding the Listing of New Futures and Option Contracts by Foreign Boards of Trade that have Received Staff No-Action Relief to Provide Direct Access to their Automated Trading Systems from Locations in the United States.<sup>55</sup>

The scope of the Division's no-action position is restricted to providing relief from the requirement that TFX obtain DCM designation or DTEF registration pursuant to Sections 5 and 5a, respectively, of the CEA and regulatory requirements that flow specifically from the DCM

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<sup>54</sup> The Division notes that the foregoing is not intended to be an exhaustive list of the factors relevant to its decision to grant the no-action relief requested by TFX nor of the factors that the Division might consider when analyzing no-action requests from other exchanges. No-action requests, by their nature, require case-by-case evaluation and the Division's conclusion regarding any particular no-action request will be based upon the facts and circumstances presented at the time of its review of that request.

<sup>55</sup> 71 Fed. Reg. 19877 (April 18, 2006); corrected at 71 Fed. Reg. 21003 (April 24, 2006). Furthermore, TFX has represented that it will not permit trades to be made in unapproved products for the account of any TFX member that is located in the U.S.

designation and DTEF registration requirements if the above-referenced contracts are made available in the U.S. for trading through LIFFE CONNECT™ in the manner set forth herein. The Division's no-action position does not extend to any other provision of the CEA, any other Commission regulations, or to any registered futures association rules and does not excuse TFX or its members from compliance with any applicable requirements thereunder. Nor does the no-action position alter, restrict, or expand the coverage of existing Commission exemptions for particular products.

The Division specifically notes that its no-action position does not alter the general requirement that a firm operating pursuant to the no-action relief provided herein must be appropriately registered or exempt from such registration to engage in the offer or sale of a foreign futures contract or a foreign option transaction for or on behalf of a U.S. customer. For example, nothing in this letter is intended to alter current Commission rules that require that any foreign firm that clears trades on a fully-disclosed basis on behalf of U.S. persons (including where the U.S. person is a non-clearing member of a foreign board of trade trading solely for its own account) be a registered FCM or a Rule 30.10 Firm.<sup>56</sup> However, if a foreign firm solely carries accounts on behalf of U.S. customers that are the foreign firm's or any registered FCM's proprietary accounts (as defined in Rule 1.3(y)) or the foreign firm is either a member of the relevant foreign board of trade or is a foreign affiliate of a registered FCM and its sole contact with a U.S. customer is that it carries the FCM's omnibus account, then the firm need not register under Rule 30.4 nor confirm relief under Rule 30.10.

Moreover, the Division's no-action position does not amend, revise, or negate the obligations of CPOs, CTAs, FCMs and Rule 30.10 Firms under the CEA, Commission regulations, or Rule 30.10 orders. For example, Rule 30.10 Firms continue to be prohibited from maintaining a presence in the U.S. Thus, Rule 30.10 Firms cannot provide direct access to the trading system in the U.S. (although they would be permitted to accept orders overseas from customers located in the U.S. that submit such orders by telephone or through an AORS located in the U.S.). FCMs or Rule 30.10 Firms who solicit or accept orders from U.S. customers for trading on the trading system remain responsible for, among other things, complying with risk disclosure, the handling and allocating of customer orders, and the segregation of customer funds.

The Division's no-action position does not affect the Commission's ability to bring appropriate action for fraud or manipulation. The Division specifically notes that the use of AORSs to transmit orders to LIFFE CONNECT™ shall be subject to all existing Commission rules and regulations and to any future rules or guidance issued by the Commission or the Division. Finally, this letter does not address issues that might arise under the Securities Act of 1933, the Securities Exchange Act of 1934, or any other applicable federal securities law or rule

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<sup>56</sup> At this time, the Commission has not issued a Rule 30.10 order to TFX permitting its members to conduct brokerage activities on behalf of U.S. persons without having to register as an FCM. However, TFX members otherwise may qualify as a Rule 30.10 firm pursuant to other orders issued by the Commission pursuant to Rule 30.10. See, e.g., 67 FR 30785 (May 8, 2002) (permitting firms authorized by Eurex Deutschland to solicit and accept orders from U.S. persons for otherwise permitted transactions on all non-U.S. exchanges where such members are authorized to conduct business on behalf of customers pursuant to German law).

promulgated thereunder.

The Division's no-action position is subject to compliance with the following conditions:

1. TFX will continue to satisfy the criteria for approval by the Prime Minister as a financial futures exchange under the laws of Japan with respect to transactions effected through the trading system.
2. The laws, systems, rules, and compliance mechanisms of Japan applicable to TFX will continue to require TFX to maintain fair and orderly markets; prohibit fraud, abuse, and market manipulation; and provide that such requirements are subject to the oversight of appropriate regulatory authorities.
3. TFX will continue to adhere to the IOSCO Principles, as updated, revised, or otherwise amended to the extent consistent with United States and Japanese law.
4. Only members of TFX will have direct access (*i.e.*, not through an AORS) to the trading system from the United States and TFX will not provide, and will take reasonable steps to prevent third parties from providing, such access to TFX to persons other than TFX members.<sup>57</sup>
5. All orders that are transmitted to the trading system by a member of TFX that is operating pursuant to the no-action relief provided herein will be solely for the member's own account unless (i) such member is registered with the CFTC as an FCM or is a Rule 30.10 Firm, or (ii) such member is registered with the CFTC as a CPO or CTA, or is exempt from such registration pursuant to Commission Regulation 4.13 or 4.14, provided that an FCM or Rule 30.10 Firm acts as clearing firm and guarantees without limitation all positions of such CPO or CTA effected through submission of orders on the trading system.
6. All orders for U.S. customers accepted through an AORS and transmitted by TFX members through LIFFE CONNECT™ pursuant to the relief granted herein will be intermediated by a TFX member that is either registered with the CFTC as an FCM or is a Rule 30.10 Firm.
7. Prior to operating pursuant to the no-action relief requested herein, TFX will require each current and prospective member that is not registered with the Commission as an FCM, a CTA or a CPO to execute and file with TFX a written representation, executed by a person with the authority to bind the member, stating that as long as the TFX member operates pursuant to the no-action relief provided herein, the member agrees to and submits to the jurisdiction of the CFTC with respect to activities conducted pursuant to the no-action relief. TFX will maintain the foregoing representations as long as the relevant member is operating pursuant to the no-action relief and shall make such representation available to the Commission upon the request of a CFTC representative.

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<sup>57</sup> For purposes of these conditions, "member" includes those affiliates identified in footnote 2.

8. Prior to their operating pursuant to the no-action relief provided herein, TFX will require each current and prospective member that is not registered with the CFTC as an FCM, a CTA or a CPO to execute and file with TFX a valid and binding appointment of a U.S. agent for service of process in the U.S. pursuant to which the agent is authorized to accept delivery and service of “communications” issued by or on behalf of the CFTC.<sup>58</sup> TFX will maintain the foregoing appointments as long as the relevant member is operating pursuant to the no-action relief and shall make such appointments available to the CFTC upon the request of a Commission representative.

9. Prior to their operating pursuant to the no-action relief provided herein, TFX will require each current and prospective member of the Exchange that is not registered with the CFTC as an FCM, a CTA or a CPO to file with TFX a written representation, executed by a person with the authority to bind the member, stating that as long as the member operates pursuant to the no-action relief provided herein, the member will provide, upon the request of the Commission, the U.S. Department of Justice and, if appropriate, the National Futures Association (NFA), prompt access to original books and records maintained at their U.S. offices as well as to the premises where LIFFE CONNECT™ is installed or used in the U.S. TFX will maintain the foregoing representations as long as the relevant member is operating pursuant to the no-action relief. TFX will make such representations available to the CFTC upon the request of a Commission representative.

10. Prior to operating pursuant to the no-action relief provided herein, TFX will file with the Division, and maintain thereafter as long as TFX operates pursuant to the no-action relief, a valid and binding appointment of a U.S. agent for service of process in the U.S., pursuant to which the agent is authorized to accept delivery or service of “communications”, as defined above, that are issued by or on behalf of the CFTC.

11. TFX will maintain the following updated information and submit such information to the Division on at least a quarterly basis, and at any time promptly upon the request of a Commission representative, in the format reflected in the attachment to this letter:

a. For each contract available to be traded on the trading system, (1) the total trade volume originating from electronic trading devices providing direct access to LIFFE CONNECT™ in the U.S., (2) the total trade volume for such products traded through the trading system worldwide, and (3) the total trade volume for such products traded on TFX generally; and

b. A listing of the names, NFA ID numbers (if applicable), and main business addresses in the U.S. of all TFX members that have access to the trading system in the U.S.

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<sup>58</sup> For purposes of these conditions, “communications” is defined to include any summons, complaint, order, subpoena, request for information, or notice or any other written or electronic documentation or correspondence issued by or on behalf of the Commission.

12. TFX will request that the FSA provide to the Division not later than July 1<sup>st</sup> of each year a letter or email confirming that TFX retains its authorization in good standing as a financial futures exchange under the Financial Instruments and Exchange Law or other exchange licensing methodology used in Japan.
13. TFX will promptly provide the Division with written notice of the following:
  - a.. Any material change in the information provided in its No-action request, including any information contained in the documents submitted in support thereof;<sup>59</sup>
  - b. Any material change in TFX's Rules or the laws, rules, and regulations in Japan relevant to futures and options;
  - c. Any matter known to TFX or its representatives that, in TFX's judgment, may affect the financial or operational viability of TFX, including, but not limited to, any significant system failure or interruption;
  - d. Any default, insolvency, or bankruptcy of any TFX member known to TFX or its representatives that may have a material, adverse impact upon the condition of TFX, TFX Clearing, or upon any United States customer or firm;
  - e. Any known violation by TFX or any TFX member of the terms or conditions of the no-action relief provided herein; and
  - f. Any disciplinary action taken by TFX against any TFX member operating pursuant to the no-action relief provided herein that involves any market manipulation, fraud, deceit, conversion or that results in suspension or expulsion and that involves the use of LIFFE CONNECT™ or an AORS to submit orders to TFX and either (1) the TFX member against whom the disciplinary action is taken is located or based in the U.S. or (2) the disciplinary action results, in whole or in part, from conduct that: (i) involves the use of a terminal or an AORS that is located in the U.S. to accept or submit an order for trading through LIFFE CONNECT™; (ii) involves a U.S. customer or firm or registered FCM; or (iii) might have a material, adverse impact upon any U.S. customer or firm.
14. Satisfactory information-sharing arrangements between the Commission and the relevant Japanese regulatory authorities will remain in effect.
15. The Commission will be able to obtain sufficient information regarding TFX and its members operating pursuant to the no-action relief provided herein, and TFX will provide

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<sup>59</sup> The Division notes that "material" changes in the information provided to it in support of this No-action request would include, without limitation, a modification of: TFX's membership criteria; the location of TFX's management, personnel or operations (particularly changes that may suggest an increased nexus between TFX's activities and the U.S.); the basic structure, nature, or operation of the trading system; or the regulatory or self-regulatory structure applicable to TFX members.

directly to the Commission information necessary to evaluate the continued eligibility of TFX or its members for the relief, to enforce compliance with the terms and conditions of the relief, or to enable the Commission to carry out its duties under the CEA and Commission regulations and to provide adequate protection to the public or U.S. contract markets and DTEFs.

16. TFX will employ reasonable procedures, to be determined by TFX, for monitoring and enforcing compliance with the terms and conditions of the no-action relief provided herein.

The no-action position taken herein is taken by the Division only and does not necessarily reflect the views of the Commission or any other unit or member of the Commission's staff. It is based upon the information and representations contained in TFX's No-action request and the materials submitted in support thereof. Any materially different, changed, or omitted facts or circumstances may render this letter void. The Division specifically notes that it will examine the volume information submitted as a condition to the no-action relief provided herein as well as any changes in the nature or extent of TFX's activities in the U.S. to ascertain whether TFX's presence in the U.S. has increased to a level that might warrant reconsideration of the no-action relief. Finally, as with all no-action letters, the Division retains the authority to condition further, modify, suspend, terminate, or otherwise restrict the terms of the no-action relief provided herein, in its discretion.

If you have any questions regarding this correspondence, please contact Duane C. Andresen, Special Counsel, at [dandresen@cftc.gov](mailto:dandresen@cftc.gov) or by phone at (202) 418-5492.

Very truly yours,

Richard A. Shilts  
Director

cc:

Gregory C. Prusik, Vice-President Compliance and Registration, NFA  
Branch Chief, Audit and Financial Review Unit, Division of Clearing and Intermediary  
Oversight, Chicago Regional Office

Attachment