



U.S. COMMODITY FUTURES TRADING COMMISSION

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Division of
Market Oversight

CFTC Letter No. 11-02
No-Action
June 1, 2011
Division of Market Oversight

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1875 Pennsylvania Avenue, NW
Washington, DC 20006

Re: Osaka Securities Exchange Co., Ltd. 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 February 10, 2010 to the Division of Market Oversight (Division) of the Commodity Futures Trading Commission (CFTC or Commission).¹ By this correspondence, you request, on behalf of the Osaka Securities Exchange Co., Ltd. (OSE or the Exchange) that the Division confirm that it will not recommend that the Commission take enforcement action against OSE or its Transaction Participants (TP) or entities located in the United States² (Remote TPs) that have been authorized to directly access the OSE's electronic trade matching system, the OSE Trading System (OSE-TS or J-GATE), if OSE does not seek designation as a contract market (DCM) pursuant to Section 5 of the Commodity Exchange Act (CEA or Act)³ or as a derivative transaction execution facility (DTEF) pursuant to Section 5a of the Act or Commission rules thereunder (no-action request).⁴

¹ Letter from Paul M. Architzel, Esq., Alston & Bird LLP, to Rick Shilts, Acting Director, Division of Market Oversight, Commodity Futures Trading Commission (February 10, 2010), supplemented by a revised and amended no-action request dated March 22, 2011.

² For purposes of this letter and the relief provided herein, the term "United States" shall include the United States, its territories and possessions.

³ 7 U.S.C 1 *et seq.*

⁴ The Division notes that, pursuant to the Dodd-Frank Wall Street Reform and Consumer Protection Act, Public Law 111-203, 124 Stat. 1376 (2010) (Dodd-Frank Act), DTEFs are to be eliminated as a class of registrant.

Specifically, OSE wishes to make the OSE-TS available through direct access⁵ through the online interface using a library of application program interfaces provided by OSE to Remote TPs that are so authorized in the U.S. that:

- (1) are located in the U.S and trade for their own accounts;
- (2) are registered with the Commission as Futures Commission Merchants (FCM) or are exempt from such registration pursuant to Commission Rule 30.10 (Rule 30.10 Firms)⁶ and that submit orders from or on behalf of U.S. customers⁷ to the OSE-TS 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 the clearing firm and guarantees without limitation all positions of the CPO or CTA effected through submission of orders on the OSE-TS; and
- (4) are registered with the Commission as FCMs or are Rule 30.10 Firms and accept orders through U.S. automated order routing systems (AORS)⁸ from U.S. customers for transmission to the trading system.

⁵ For purposes of this letter and the relief provided herein, the term “direct access” refers to the explicit grant of authority by OSE to a TP (including Remote TPs) to enter trades directly into OSE’s trading system.

⁶ 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 (2011).

⁷ For purposes of this letter and the relief provided herein, the term “United States or U.S. customers” shall have the same meaning as the term “foreign futures or foreign options customers” as defined in Rule 30.1(c).

⁸ For purposes of this letter and the relief provided herein, the term “AORS” is 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 OSE-TS where, without substantial human intervention, trade matching or execution takes place.

The Division has reviewed OSE's no-action request pursuant to the Order issued by the Commission on June 2, 1999, which first directed Commission staff to consider requests from foreign exchanges for no-action relief to allow them to provide direct access to their trading systems from the U.S.⁹ and the Policy Statement issued by the Commission on October 27, 2006, in which the Commission 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.¹⁰ OSE's no-action relief and the information and documentation provided in support thereof have been examined by relevant staff using the standards of review that have been used for similar no-action requests in the recent past and the information and documentation have been deemed sufficient for the purpose of the issuance of this no-action relief letter.

It should be noted that Section 738 of the Dodd-Frank Act amended section 4(b) of the CEA¹¹ to authorize the Commission to adopt rules and regulations requiring foreign boards of trade that provide their members or other participants that are located in the U.S. with direct access to their electronic trading and order matching systems to register with the Commission, including rules and regulations prescribing the procedures and requirements applicable to such registration.¹² Pursuant to this authority, the Commission issued proposed regulations on November 19, 2010 that would obligate such foreign boards of trade to register with the Commission.¹³ The proposed regulations also delineate the requirements and conditions that would be imposed upon such registration. Nothing in this letter should be viewed as an interpretation of the proposed regulations or any provision of the statute under which they were issued.¹⁴

In the event that the Commission adopts final regulations pursuant to Section 738 that would require OSE to register with the Commission, OSE would be obligated to demonstrate that it satisfies all of the requirements of such registration in accordance with the standards applicable to such registration (which may differ from the standards applicable to the no-action

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

¹⁰ *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 (Nov. 2, 2006).

¹¹ 7 U.S.C. 6(b)

¹² Section 4(b) of the CEA defines "direct access" as "an explicit grant of authority by a foreign board of trade to an identified member or other participant located in the United States to enter trades directly into the trade matching system of the foreign board of trade." *Id.*

¹³ *Registration of Foreign Boards of Trade*, 75 Fed. Reg. 70973 (proposed Nov. 19, 2010) (to be codified at 17 C.F.R. Part 48).

¹⁴ OSE has requested a no-action position from the Division in order to provide immediate, interim relief to it and its TPs, pending the adoption of the final rules governing the registration of foreign boards of trade by the Commission. OSE would be subject to any final regulations adopted by the Commission applicable to foreign boards of trade that provide direct access to their electronic trading systems and regulations and that otherwise relate to the issues addressed herein. Such regulations would supersede the no-action relief provided by this letter. In addition, the Division retains the authority to condition further, modify, suspend, terminate or otherwise restrict or revoke any and all of the terms of the no-action relief.

relief granted herein). OSE may be obligated to provide additional or updated information, documentation, or other materials staff deems necessary to its evaluation of OSE's application for registration or to establish that the requirements and conditions of such registration are satisfied in accordance with the relevant standard of review.

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

- General information about OSE, including its history, location, and organization;
- OSE's Articles of Incorporation;
- Information about the criteria governing access rights;
- Regulations for Transaction Participants;
- Enforcement Rules of Regulations for Transaction Participants;
- Information about the terms and conditions of the contracts proposed to be offered pursuant to the no-action relief;
- Information about various aspects of the OSE-TS (including the order-matching system, audit trail, response time, reliability, security, and adherence to the Principles for the Oversight of Screen-Based Trading Systems for Derivative Products [IOSCO Principles]);
- GATENET Access Guideline;
- Information about OSE's clearing and settlement system;
- OSE's Clearing Rules;
- OSE's Clearing and Settlement Regulations;
- The OSE Clearing System Online Interface Specification;
- Information about OSE's home country regulatory regime, including information regarding OSE's status in its home jurisdiction, applicable home country regulations and the enforcement thereof (including market surveillance and trade practice surveillance);
- The Financial Instruments and Exchange Act (FIEA);
- OSE's Business Regulations;

- OSE's Regulations Regarding Fair and Equitable Principles of Transactions;
- OSE's Regulations Regarding Examinations for Acquisition of Trading Qualification;
- OSE's Special Rules for the Listing Regulations for Securities, Business Regulations, Regulations regarding Margin and Loan Transactions, and Brokerage Agreement Standards Relating to the J-NET Market;
- OSE's Rules for Margins and Transfer of Unsettled Positions for Futures and Options Trading (Rules for Margins);
- OSE's Inspection Regulations;
- A description of current information-sharing agreements to which OSE and its regulators are parties;
- A certification of an authorized representative of OSE as to the truth and completeness of the material facts set forth in the no-action request; and
- An undertaking of an authorized representative of OSE to notify the Commission staff if any material representation ceases to be true and complete.

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

Representations made by OSE regarding the structure of OSE, OSE's activities in the U.S., OSE's TP and clearing participant (CP) criteria, OSE's electronic trading and order matching system, OSE's clearing and settlement system, the relevant regulatory regime in Japan, to which OSE is subject and the information-sharing arrangements applicable to OSE and its regulator are summarized in Sections I - VII below. For purposes of this response to OSE's no-action request, the Division has relied upon OSE's representations and the information and documentation provided by OSE and has not conducted an independent review to confirm their accuracy.¹⁵

¹⁵ The no-action relief provided herein is contingent upon the accuracy and completeness of the representations made by, and the information and documentation provided by, OSE 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.

I. GENERAL INFORMATION REGARDING OSE

A. History and Organization

The OSE was established on April 1, 1949, as a nonprofit membership organization under Japan's Securities and Exchange Law.¹⁶ On April 1, 2001, the OSE converted its membership organization into a joint-stock corporation. Licensed to act as a financial instruments exchange by the Prime Minister of Japan under the Financial Instruments and Exchange Act (FIEA),¹⁷ the OSE is authorized to trade securities and to conduct a market for transactions in derivatives and was the first financial instruments exchange to trade equity derivatives in Japan.¹⁸ As a self-regulatory organization, the OSE is obligated to enforce its rules and has established the Self-Regulation Committee to make decisions on matters relating to its self-regulatory operations.

The OSE is the largest equity derivatives exchange in Japan as measured by trading volume and contract values. The OSE is the second largest (after the Tokyo Stock Exchange) of the six Japanese financial instruments exchanges that trade cash products based upon the amount of business handled. The OSE is the leading exchange for derivatives products in Japan and its trading volume is the largest among the seven Japanese exchanges handling derivatives products. In 2010, the OSE handled 90% of the stock index futures market in Japan and almost 100% of trading in the stock index options market as measured by volume.

The OSE is owned by its shareholders and, as of December 31, 2010, was capitalized in the amount of ¥4.723 billion (approximately \$55,943,900).¹⁹ It is overseen by a Board of Directors (Board) composed of eleven individuals, six of whom are outside directors, and the Self-Regulation Committee, composed of one full-time director and two outside directors, pursuant to the FIEA, in order to provide for the independence of the Exchange's self-regulating activities. The OSE employs a statutory auditor system to monitor management and has a Board of Auditors composed of three auditors, two of whom are outside auditors. In addition, the Board has established three Standing Committees: the General Advisory Committee, the Clearing & Settlement Committee, and the Clearing Risk Assessment Committee. These committees assist the Board in discussing various proposals and recommending policies to be adopted and actions to be taken by the Board. As of December 31, 2010, the OSE has a staff comprised of 338 people.

¹⁶ The OSE's predecessor was the Osaka Stock Exchange Co., Ltd., established in 1878.

¹⁷ The Securities and Exchange Law was superseded by the FIEA on September 30, 2007. The FIEA defines as a "financial instruments exchange" an entity that the Securities and Exchange Law previously defined as a "stock exchange."

¹⁸ The equity derivatives products authorized for trading include futures and options on stock indexes and options on securities, including options on equities, ETFs and REITs.

¹⁹ The OSE has a policy of stable and continuous dividend payments, with approximately 40% of dividend payout ratio and approximately 4% of dividend on equity ratio at the minimum. The annual dividend for fiscal year 2009 (from April 2009 to March 2010) was ¥9,000 (\$106.60) per share. As of April 6, 2011, ¥84.42 = \$1.00.

B. Products

OSE proposes to make the following five broad-based stock index futures contracts, each of which previously has been the subject of a no-action relief letter from the Commission's Office of the General Counsel (OGC) permitting the contract to be traded by U.S. persons, available for trading via direct access from the U.S.:

- MSCI Japan Index Futures Contract²⁰
- Russell/Nomura Prime Index Futures Contract²¹
- Mini Nikkei 225 Index Futures Contract²²
- Nikkei Stock Average Index (Nikkei 225) Futures Contract²³
- Nikkei 300 Index Futures Contract²⁴

You represent that OGC, in issuing the no-action relief letters for the contracts, determined that OSE demonstrated that each contract satisfied the statutory standards, including the following: (1) the contract must be cash-settled; (2) trading in the contract must not be readily susceptible to manipulation; and (3) the group or index of securities must constitute a broad-based security index.²⁵ You represent that the five contracts remain in compliance with these requirements and the terms of the OGC no-action letters. Division staff has reviewed the contract specifications and concluded that the contracts do not otherwise present regulatory issues warranting additional terms and conditions to those included in the OGC no-action letters.

C. Presence in the United States

OSE currently does not have a representative office in the United States. Its activities in the U.S. are limited to participation in various widely-attended industry conferences and trade shows to acquaint the futures industry generally with OSE and the contracts traded thereon. In connection with its participation in such industry events, the OSE responds to inquiries from the press and the public and provides general information. It may also conduct seminars relating to

²⁰ CFTC Staff Letter 03-06 (February 13, 2003).

²¹ CFTC Staff Letter 05-04 (March 14, 2005).

²² CFTC Staff Letter 06-14 (July 10, 2006).

²³ CFTC Staff Letter 92-1 (January 16, 1992).

²⁴ CFTC Staff Letter No. 94-43 (May 17, 1994).

²⁵ Subsequent to passage of the Commodity Futures Modernization Act of 2000, Public Law 106-554, 114 Stat. 2763 (2000) (CFMA), the third criterion for issuance of OGC no-action relief is whether such contracts do not constitute a narrow-based security index. Contracts granted relief prior to 2000 that met the broad-based criterion, including OSE's contracts, were grandfathered with respect to the revised criterion of "not constituting a narrow-based security index."

trading on OSE.²⁶ OSE's English-language website is located at <http://www.ose.or.jp/e/index.html>.²⁷

Although OSE currently does not plan to open a representative office in the U.S., you represent that it may do so in the future. Such an office would promote OSE and its trading products in the U.S and represent OSE to the Commission and the press. If OSE does open such a U.S. office, it would not provide investment advice or technical support from the U.S. The office would neither be used to solicit, receive nor direct orders with respect to the products traded on the Exchange, nor would it be used to conduct trade matching or to operate a clearing facility in the U.S.²⁸

II. ACCESS TO THE TRADING SYSTEM

A. Introduction

In order to ensure fair and efficient execution of transactions on its market, as well as to ensure the financial integrity of its market, only those entities with access privileges may trade directly on the OSE. As a result of demutualization, ownership interest in the OSE has been separated from access privileges. OSE permits access to those that qualify as one of three types of Transaction Participants (TP): (1) Cash TPs, (2) Futures, etc., TPs and (3) IPO TPs.

B. Transaction Participants

Every entity wishing to become a TP must acquire a Trading Qualification (TQ), as specified in the Regulations for Transaction Participants (Regulations for TPs), prior to conducting transactions on the OSE. A Futures, etc., TQ is needed to execute stock index futures transactions, options on securities transactions or stock index options transactions. To acquire a TQ, an entity must submit an application, be subject to examination by the OSE and pay a qualification examination fee. A Japanese applicant for a TQ to trade futures and related instruments, must have a stated capital amount of no less than ¥300 million (approximately \$3,553,500), a net asset ratio no less than 100% and a capital adequacy ratio of no less than 200%. Remote TPs will not be subject to the Japanese capital adequacy ratio. Rather, OSE will rely on the capital rules that Remote TPs are subject to by their home-country regulators.

²⁶ You represent that upon issuance of this no-action letter, the OSE may also hold informational meetings in the U.S. for potential participants desiring to access the market directly.

²⁷ The website includes general information relating to the Exchange, its corporate organization, the contracts traded thereon and on various market mechanisms (such as give-ups, non-auction transactions and margin and clearing). Moreover, the website provides the public with access to certain market data, including in the "Daily Official List" daily open, high, low, close, volume, open interest, last quotation, net change and settlement price. It also includes historical archived volume information.

²⁸ Accordingly, you request that the Commission not treat it as a change in the facts or circumstances represented in its no-action request if OSE in the future opens such a representative office, as long as the operation of such an office is only for the purposes stated in the request.

Additionally, the applicant must have a sound management structure and an appropriate system for business operation and is expected to show stable profitability.

After its application to become a TP is approved by the OSE, the entity, pursuant to the Regulations for TPs, must pay a participation fee, execute a TP Agreement, undertake procedures to acquire any clearing qualifications (CQ) or establish a clearing relationship with a CP, deposit guarantee funds, and execute any other procedures stipulated by the OSE for acquiring a TQ. TPs also must pay a basic fee, a transaction fee, access fees, give-up fees, positions transfer fees, and cancellation fees on a monthly basis. In addition, TPs are required to register with OSE either a director or executive officer (TP Representative) to represent the TP at the OSE. Although only the TP Representative may represent the TP in its relationship with the OSE, routine day-to-day business, the scope of which has been determined in advance, can be carried out by an agent registered with the OSE. Similarly, TPs must notify OSE of an office which is conveniently located for liaising with the OSE to receive notifications from the OSE. A remote TP is required to register with OSE the name and address in Japan of its representative person, as prescribed in the FIEA.

TPs must deposit ¥3 million (approximately \$35,535) (or, except for remote TPs, securities in lieu of cash in accordance with OSE stipulations) with the OSE as a guarantee fund, designed to assist in the settlement of contracts for the TP's customers.²⁹ In contrast to the clearing deposit, customers for whom a TP has executed the purchase and sale of market transactions in derivatives have the right to receive, in preference over other creditors, payment from the guarantee funds of the TP for claims that arise due to such executions. The remainder of the guarantee fund may be used to recoup the losses caused to OSE, in accordance with the OSE's loss-sharing rule, in the event of a default of a TP that is a CP.³⁰ The OSE holds the guarantee funds separately from its own assets and manages them in the following ways: (1) purchase of government bonds or municipal bonds, (2) bank deposits, or (3) monetary trust with a bank engaging in trust business. As of December 31, 2010, the guarantee fund held deposits of ¥605 million (approximately \$7,166,230).

In addition to qualifications, fees and notification requirements, TPs must, pursuant to the Regulations for TPs, comply with several self-regulatory requirements and OSE mandates. For example, TPs must establish transaction management procedures which help prevent unfair trading and establish order management procedures to prevent the acceptance and placement of erroneous orders. Furthermore, TPs must ensure fair pricing and smooth circulation on the OSE markets and make best efforts to preserve and improve the function of the OSE as a financial instrument exchange market. Additionally, a TP must notify the OSE in advance, and in some cases seek OSE approval, when terminating its business, merging with another legal entity,

²⁹ Payments to the guarantee fund are deposited with OSE in its capacity as a financial instruments exchange. Only TPs are required to deposit into the guarantee fund. Accordingly, only CPs that are also TPs are required to contribute. Upon resolution of the Board, if specifically considered necessary, the OSE can raise the guarantee fund amount and/or limit the securities eligible to be deposited in lieu of cash.

³⁰ A TP cannot request the return of the guarantee funds until six months after the date from which its TQ is withdrawn. Moreover, TPs cannot assign or offer for collateral the right to claim the return of the guarantee funds.

dissolving, transferring the whole business, changing the corporate name, or changing directors. Lastly, TPs must submit documents in response to OSE's requests regarding investigations into the financial condition of the TP, investigations for purposes of maintaining fairness in transactions, or where the OSE considers it appropriate.

A TP may trade for its own account or on behalf of others, subject to certain specific requirements if the TP is trading on behalf of another.³¹ TPs that trade on behalf of others are required to comply with the Brokerage Agreement Standards stipulated by the OSE, and such TPs must conduct an investigation in advance of opening a customer account to verify the customer's name and various other matters.

In addition to these self-regulation and compliance requirements, the OSE reserves emergency authority which allows it to impose restrictions on a TP's business when the OSE believes there is an urgent need to do so in light of the objectives of OSE and operation of its markets. Pursuant to its Articles of Incorporation, the OSE, by resolution of its Self-Regulation Committee, may take disciplinary action(s), including suspension from trading and imposing fines of not more than ¥100 million (approximately \$1,184,500), against a TP for breaches of laws and regulations, of dispositions of government authorities thereunder or OSE rules, or for behaving contrary to the fair and equitable principles of transactions.

III. THE OSE TRADING SYSTEM

At the outset, the Division notes that the description of OSE-TS set forth herein is based upon representations made by OSE or its representatives. The Division has not performed an independent assessment of the security or soundness of OSE-TS in connection with this request.

A. Introduction

The OSE-TS, known as J-GATE, was developed by using Click-XT, a trading system for exchanges powered by NASDAQ OMX Group.³² OSE provides TPs with certain components of the system, while requiring them to purchase other elements. Specifically, OSE supplies the central order processing facilities of the system, known as the Central System and located in Japan, and a library of application program interfaces (API Kit) for the online interface, through which a TP's front-end trading application (API Client) communicates with the Central System.

³¹ Trading on behalf of others is referred to in the OSE Regulations for TPs as "acceptance of entrusted transactions."

³² OMX provides technology to over 60 exchanges, clearing organizations and central securities depositories in more than 50 countries. Commission staff has previously reviewed earlier versions of OMX trading systems. For example, the OM CLICK trading system, used by BrokerTec Futures Exchange, L.L.C. (BTEX), was thoroughly examined by the Division and the Commission's Office of Information Resources Management in connection with BTEX's application to become a DCM. The Commission approved BTEX as a DCM on June 18, 2001; it ceased operations in November 2003. Commission staff also has previously described OM CLICK in connection with the granting of direct access no-action relief to the OM London Exchange Limited (no longer in operation) and, more recently, to Nord Pool ASA (Nasdaq OMX Oslo ASA). See CFTC Staff Letters 00-93 (September 21, 2000) and 08-14 (August 20, 2008), respectively.

OSE TPs choose their own, and are responsible for their own use of, communication equipment, communication lines and a connection configuration from the communication equipment and access line products, which include, for example, provider, line type, and bandwidth. OSE provides an integrated network (GATENET) for TPs to perform transactions with OSE employing leased lines to deliver high quality, high performance, high reliability and security. J-GATE is comprised of the following main components: (1) the Central System; (2) API Client; (3) GATENET; and (4) the security system.

B. The Central System

The Central System performs the security, order processing, and connection monitoring functions of the J-GATE. Among other things, the Central System maintains a database of currently authorized OSE traders, validates a trader's authority to trade on OSE, processes and records all orders, validates requests for order modifications and cancellations, matches orders, maintains the central order book, sends market broadcast data messages (*i.e.*, order book information, open, high, low and close prices and the data on trading suspension, etc.) to the API Client, and monitors the status of the system connections between the Central System and the API Client. You represent that the Central System underwent comprehensive business and technical testing before it was declared operational.

1. The Auction-driven Market

The J-GATE is used to access two forms of trading.³³ The first is the auction-driven market under which bids and offers are entered through the J-GATE where they are matched by the Central System using an auction process.³⁴ The Central System uses time-price priority sequencing in matching and executing orders, so that the best bid is matched to the best offer, giving priority for bids or offers at the same price to the first entered into the system. If an order can only be partially filled, the next oldest bid or offer at that price is matched until the remainder of the order is filled, and if the amount bid or offered at that price is exhausted, the unfilled portion of the order is then executed at the next best price beginning with the oldest bid or offer.

In the auction-driven market, the J-GATE supports the following types of orders: (1) market order, submitted without a specified limit price and to be executed against the best bid or best offer in order (any unfilled part of the market order is cancelled); (2) limit order, submitted with a specified limit price and to be executed at the specified or a better price; (3) market to limit order, a limit order submitted without the specified limit price and to be executed against the best bid or best offer at the time;³⁵ and (4) stop order, an order recorded in a separate database

³³ See <http://www.ose.or.jp/e/index.html>.

³⁴ The auction-driven market is open for two sessions daily (all times shown in JST): the Day Session, 9:00 am to 3:15 pm; and the Evening Session, 4:30 pm to 11:30 pm.

³⁵ If there is no best offer or best bid to be matched with, a market to limit order conditioned as fill and store is recorded on the order book as a limit order at the better price than the best bid or best offer by one tick; provided, however, that the order becomes invalid if there is no best bid or best offer.

in conjunction with one of the three types of orders identified above and containing a pre-specified triggering condition that, when touched, causes the order to enter into the trading system for execution as a market, limit or market to limit order, as applicable. Orders may additionally specify the following conditions: (1) Fill and Store (FAS), where any unfilled volume after the order is partially executed remains on the order book to be matched; (2) Fill and Kill (FAK), where any unfilled volume after the order is partially executed is canceled, (3) Fill or Kill (FOK), where the order is canceled if the entire order cannot be executed immediately, (4) Good for Day (GFD), where an order remains valid until the end of the trading session, (5) Good till Date (GTD), where an order remains valid until the end of the day session on the date the specified period ends (up to 255 days), and (6) Good till Cancel (GTC), where an order remains valid until cancelled (if not cancelled, it is valid until the end of the day session on the last trading day).

2. Non-Auction Trade Matching

In addition, the J-GATE supports non-auction trade matching (the J-NET market). This facility, known as the J-NET Derivatives Trading System, makes use of the J-GATE to execute orders such as block trades, Exchange of Futures for Physicals, Volume Weighted Average Price, option strategy trading (strangle, calendar spreads, etc.), and strategies combining block trades of futures and options, such as hedging futures by options and arbitrage trade of futures using options.³⁶ The J-NET market began as a block trading facility for cash products and, in January 2008, replaced the Non-Auction Large Block Trading System, which had enabled buyers and sellers to trade futures and options contracts in increments larger than those prescribed by OSE at previously agreed upon prices that were within price ranges prescribed by OSE.³⁷

In addition to enabling TPs to execute orders such as block trades, that are within a range specified by OSE but which are agreed upon before being entered into the J-GATE, the J-NET market provides the functionality to enter into trading strategies that make use of theoretical pricing relationships keyed off of a market-based price, such as calendar spreads. Finally, the J-NET market provides for the entry of transactions based upon observed market prices, such as volume weighted average prices. All of these types of transactions take place subject to the rules of OSE, which provide strict conditions for their use.

C. The API Client

The API Client is the software installed to connect to the Central System by using the API Kit provided by OSE. Currently, OSE TPs may use the API Client developed internally or an application provided by independent software vendors to access the Central System.

³⁶ The J-NET Derivatives Trading Market is open for two sessions daily (all times shown in JST): 8:20 am to 4:00 pm and 4:30 pm to 11:30 pm.

³⁷ For example, Nikkei 225 Futures and Nikkei 300 Futures were traded in increments of at least 200 contract units (although this was later reduced to 100 units) and 500 contract units, respectively.

D. GATENET

The GATENET connects the Central System in the Tokyo metropolitan area to its TPs in Japan. When OSE adopts remote TPs in the near future, the GATENET may be expanded to connect TPs outside of Japan to the Central System. In this case, hubs in major financial centers, including hubs located in the U.S., will connect to the Central System in Japan.³⁸ You represent that orders of Remote TPs (including U.S.-located Remote TPs) arriving at the Central System through an existing point of connection or through new hubs which may be established in the future will not be treated any differently or disadvantaged by the Central System from those of OSE's TPs located in Japan.

GATENET provides two (redundant) routes for TPs to access the J-GATE. TPs connect to the Central System, which performs order acceptance, match processing, and other tasks, using the Network Gateway, which executes communication management for the API Client. Routers are also required per line and may be provided by OSE for a fee or procured by users. Purchased bandwidth is allocated to each TP and is not affected by traffic of other TPs. Access lines may be selected from among multiple providers, types and bandwidths which may be available in the TP's area. The GATENET is designed to satisfy OSE requirements, operated to strict service levels, and managed by major international network providers.

E. Audit Trail

The J-GATE captures and retains a complete audit trail including all orders, executed trades, pricing information and confirmations entered into the Central System. Information that is required to be included in orders, and which is retained by the J-GATE, includes the time of the order receipt, type of order (sell or buy), order condition, the participant code, the order price and the order amount. Audit trail information is stored and retained on magnetic media for a period of 10 years, and is readily accessible for the first five business days.

F. Data Dissemination

OSE disseminates trading data (prices/quotes) to TPs via the J-GATE.³⁹ Additional information such as total trading volume, daily high, low and last prices, inter-month spread, open interest and total trade value separately for each contract, is distributed publicly by OSE through a website on a daily basis.⁴⁰ Daily trading data and data for the past five business days are available from the same website and monthly data is available in the Monthly Statistics

³⁸ Until such new hubs are established, the manner in which the TP connects to the GATENET is up to the TP. The TP could, for example, connect to the GATENET by leasing its own lines.

³⁹ OSE Participants also have available to them from the J-GATE a summary of the TP's activity during that session, including the TP's orders entered during the current trading session and completed trades.

⁴⁰ http://www.ose.or.jp/market/daily_report/pdf_en.html /

Report or Stock Quotations section of the OSE website.⁴¹ OSE also generally makes data available to purchasers and through third party vendors, such as Bloomberg and Reuters.

G. System Reliability and Failure Recovery

The J-GATE incorporates both mechanisms for detecting system failures and procedures for ensuring recovery from such failures. Specifically, J-GATE ensures reliability by duplicating all key components of the system, including power supply, computer equipment, and network components.⁴² To that end, OSE monitors the connection service, including the connected communications equipment, 24 hours a day, and 365 days a year. If and when OSE detects a malfunction in the communication line and believes it could potentially cause some impediment to operation of the router or another key mechanical component, the TPs are contacted immediately. If it is determined that some malfunction in the communication equipment (routers, etc.) may impact the entire GATENET, the TP is required to upgrade its Internetwork Operating System version, as directed by OSE.

The J-GATE also employs backup terminals, located in Osaka and Tokyo, which allow TPs to continue to operate during most failures if the TP does not have an alternative terminal server.⁴³ To utilize the backup terminal, the TP would simply input its participant code and the user ID assigned to itself. Following recovery and prior to the resumption of trading, TPs would be informed when trading would be resumed and would be provided with the opportunity to delete their orders.

H. System Security

The J-GATE includes a security system that provides for authentication and confidentiality designed to prevent unauthorized use during API Client applications. It also ensures the integrity of the J-GATE by using features embedded in the API that cannot be accessed externally. The security system is responsible for: (1) maintaining the database of currently certified users; (2) authenticating certified users as they log on; and (3) distributing session keys as part of the login process. The J-GATE maintains a list of currently logged-in users on a real time basis through the market management terminal.

OSE assigns a unique participant code and user ID to each TP, and each TP creates a password for login to connect to the Central System. While logged into the Central System, concurrent login to the Central System using the same user ID through another API Client is not allowed.

⁴¹ <http://www.ose.or.jp/e/market/5067> OSE also makes available on its website the SPAN parameters and the theoretical option prices that are used in risk management calculations. <http://www.ose.or.jp/e/market/5052>.

⁴² All key components of the OSE clearing system (OSE-CS) are also duplicated to ensure reliability.

⁴³ OSE also maintains geographically separate back-up and disaster recovery sites where clearing and settlement data are stored and OSE-CS operations can resume. Data are sent to the back-up site every 10 to 20 minutes. Operations can be moved to the back-up site within 24 hours after a failure and clearing and settlement functions can be resumed within two hours.

I. Adherence to IOSCO Principles

You represent that the Exchange, in developing, deploying and operating J-GATE, complies with, and intends to continue to comply with, 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)⁴⁴ and adopted in principle by the Commission on November 21, 1990.⁴⁵ OSE’s adherence to the IOSCO Principles is illustrated by the fact that OSE has developed, deployed and operated J-GATE under the supervision of, and to the satisfaction of, the FSA of Japan, which, like the CFTC, has endorsed the IOSCO Principles.

IV. SETTLEMENT AND CLEARING

A. Introduction

You have represented that OSE operates as the clearing house for all stock index futures and options transactions executed on the Exchange. As such, OSE is the universal counterparty to all such transactions on the Exchange and provides a guarantee against counterparty credit risk. You have represented that OSE conducts its clearing operation (known as a “financial instruments obligation assumption service” under applicable Japanese law) as a business incidental to its business as a financial instruments exchange pursuant to the FIEA and with the approval of the Prime Minister of Japan (by delegated authority to the Commissioner of the FSA). You have represented further that, with respect to OSE’s clearing and settlement operations, the Exchange adheres to the Recommendations for Central Counterparties (RCCPs) issued by the IOSCO Technical Committee (IOSCO) and the Committee on Payments and Settlement Systems (CPSS) in 2004, and conducts self-assessments to confirm conformity with such standards. As noted above, the Division has reviewed OSE’s no-action request and the information and documentation provided in support thereof in accordance with the standard of review that it has used previously when considering no-action requests of its type. Consistent with that approach, the Division has not required OSE to demonstrate the manner in which it satisfies each of the RCCPs.

⁴⁴ 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, and articulated for each issue 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.

⁴⁵ 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).

B. Organizational Structure

You have represented that OSE's clearing and settlement operations generally are conducted within OSE's Clearing and Settlement (C&S) Division, which is under the responsibility of OSE's Market Operations Department⁴⁶ of OSE and is subject to oversight by OSE's Internal Inspection Office. Among other things, the C&S Division is responsible for: (1) examining applicants for clearing qualifications (CQs); (2) inspecting clearing participants (CPs); (3) monitoring clearing risk management, including the monitoring of the futures and options positions held by each CP; and (4) setting SPAN risk parameters and saving the SPAN data. OSE's Internal Inspection Office is charged with: (A) conducting inspections of OSE's business, platforms, and systems operations;⁴⁷ (B) ensuring compliance with OSE's internal rules, including its Articles of Incorporation, management policies, orders, and/or instructions; and (C) other activities necessary to maintain and improve OSE's business platforms and rules.

C. Clearing Participant Requirements

You have represented that all security index futures and options transactions executed on OSE have been designated, pursuant to the Clearing Rules, as clearable transactions, the clearing of which must be conducted by or through a CP that holds a CQ⁴⁸. Thus, a TP that wishes to trade futures and options on its own behalf or on behalf of customers on OSE must either: (1) become a CP or (2) enter into a clearing entrustment agreement with a general clearing participant (GCP). TPs that do not become CPs must designate a GCP for each type of clearing qualification for which they have a clearing entrustment agreement. TPs must obtain approval from OSE prior to designating or changing their GCPs and must report to OSE when any of their clearing entrustment agreements have been terminated and the reasons for the termination. A termination based on the transactions cleared must be reported on the same day as the termination.

You have represented that an entity wishing to become a CP must apply for a CQ⁴⁹ and is subject to an examination by OSE. In considering whether to grant an application for a CQ, OSE

⁴⁶ You note that OSE's Market Operations Department is separate from its Derivatives Department, which contains OSE's Derivatives Business Development Division (the division responsible for developing new products and new systems for OSE, as well as for developing internal rules for futures and options trading). Accordingly, the C&S Division and the Derivatives Business Development Division report to different executive directors. You further note that OSE's marketing and promotional activities are conducted by a separate division (Marketing & Sales).

⁴⁷ You represent that the reviews conducted by OSE's Internal Inspection Office are equivalent to the types of reviews conducted by internal review units in the U.S.

⁴⁸ OSE assumes the obligations of both the selling and the purchasing CP.

⁴⁹ You have represented that there are two types of CQs: (1) an "Individual CQ," which does not allow brokerage (*i.e.*, it qualifies the CP only to clear transactions done by itself as TP) and (2) a "General CQ," which permits brokerage (*i.e.*, it qualifies the CP to clear transactions done by itself [if it is also a TP] and by others). A CP with an individual CQ is referred to as an "Individual CP"; a CP with a general CQ is referred to as a "GCP." All Individual CPs are also TPs and, accordingly, are required to satisfy all of the TP participant requirements. Not all GCPs are

assesses: (1) the structure of the applicant's management system; (2) the applicant's financial condition; and (3) the applicant's business operations, including whether the applicant has an appropriate method for the settlement of contracts and an appropriate risk management structure. The CQ application assessment is performed by OSE's C&S Division. You have represented that the application assessment is primarily performed through the examination of relevant documents. Such documents include: the applicant's company profile; the applicant's Articles of Incorporation; the applicant's corporate registration; the application packet required by the FIEA, and registration certification; the applicant's internal rules governing its operations, risk management, and fund segregation; the applicant's organization chart; the applicant's business reports for the last three fiscal years; descriptions of the applicant's business operations and the status of its property for the last three fiscal years; notification of the applicant's capital adequacy ratio filed at the term-end for the last three fiscal years; the report on off-site monitoring conducted by the FSA for the last year; and the inspection report issued by and/or business improvement report submitted to the applicant's regulators (*e.g.*, the FSA or SESC), if any. You also have represented that, prior to the approval of a CQ application, the person(s) in charge of the assessment visits the applicant's offices to examine the applicant's business operation system, including its infrastructure.

You have represented that OSE requires all CPs to have appropriate business operations to support their respective clearing activities. OSE specifically requires a GCP to be a "type-I financial instruments business operator" or a "registered financial institution." Registered financial institutions include financial institutions that are not securities companies, but that are allowed to engage in part of a financial instruments business. They include some banks and insurance companies. OSE requires all CPs to provide advance notice to OSE of any material change in their respective management systems and business operations including, among others, the cessation of business operations, mergers, changes in directors, or relocations of their head offices. You represent that OSE reviews such changes to determine whether they are appropriate.

You have represented that OSE also imposes certain ongoing financial requirements upon CPs. The financial requirements differ in accordance with the various methods established under Japanese law for calculating the financial soundness of different types of core businesses. For example, "registered financial institutions" are required to demonstrate their financial soundness through the calculation of their "capital ratio" under Japanese law. The capital ratio is intended to indicate, for instance, the amount of capital that a bank holds against assets that are at risk of bad debts. You have represented that OSE requires a CP that is a bank with overseas operations offices to maintain a capital ratio of no less than eight percent, calculated in accordance with the Basel II minimum capital requirements. A bank without overseas operation offices is required to maintain a capital ratio of not less than four percent in accordance with the Japanese standard.

You have represented that, under Japanese law, securities firms are required to demonstrate their financial soundness using a "capital adequacy ratio," calculated in accordance

TPs, however. You have represented that, as of December 2010, more than eighty firms were eligible to clear futures and options trades through OSE.

with the FIEA.⁵⁰ The capital adequacy ratio is intended to indicate how much “unfixed capital” a securities company holds to cover various risks, such as the price volatility risk of securities held. Securities companies are required by the FIEA to maintain a capital adequacy ratio of no less than 120%. If a security company’s capital adequacy ratio falls below 140%, it is required to report that fact to the FSA. You have represented that OSE requires CPs that are financial instruments business operators applying for a GCQ to maintain a capital adequacy ratio of no less than 200%. You have represented that current Japanese law requires that all CPs be located in Japan; Remote CPs are not permitted. Accordingly, all CPs are subject to the Japanese capital adequacy ratio requirement.

You have represented that OSE requires GCPs to have stated capital of at least ¥300 million (approximately \$3,553,500) and net assets of at least ¥20 billion (approximately \$236,900,000) that exceed the amount of stated capital. Individual CPs are required to have net assets of at least ¥2 billion (approximately \$23,690,000) that exceed the amount of stated capital.

You have represented that, after a CP has obtained a CQ, OSE’s Risk Management Team⁵¹ monitors the financial condition of the CP by reviewing certain “monitoring documents” that OSE requires the CP to submit to the Exchange. Such documents include: an annual business report; an annual financial statement; an annual report affirming the CP’s continued regulatory status and detailing the status of its property, in accordance with the FIEA, related ordinances and OSE Regulations; monthly reports on the CP’s capital adequacy ratio; monthly financial and accounting data; and a monthly report on transactions by product. You represent that, if a CP is unable to maintain the above-referenced financial requirements and falls below the level specified by OSE, OSE reserves the right, after a hearing,⁵² to suspend the whole or part of the assumption of the obligations based on clearable transactions to which the CP is a party.

You have represented that all CPs are required to register with the FSA and that OSE checks the registration status of its CPs through the FSA’s website on a daily basis. You also note that OSE rules require CPs to notify OSE upon the rescission of their regulatory license, registration, authorization or approval to conduct their respective activities and that, should a CP

⁵⁰ The “capital adequacy ratio” is also known as the “capital-to-risk ratio.” You have represented that it is calculated as follows: $(\text{unfixed capital}) / [(\text{market risk equivalent}) + (\text{counterparty risk equivalent}) + (\text{operational risk equivalent})] \times 100$, where the unfixed capital = (own capital) – (illiquid assets). For purposes of this calculation: (1) “market risk equivalent” is the amount of risk arising from price fluctuations in the securities held; (2) “counterparty risk equivalent” is the amount of risk arising from the default of a counterparty; (3) “operational risk equivalent” is the amount of risk arising from executing routine business; (4) “own capital” includes stated capital; reserve funds; profit surplus; unrealized profits for securities (excluding those securities held for trade, held-to-maturity securities, and securities used by affiliates); Treasury shares; allowances; and subordinated liabilities; and (5) “illiquid assets” include fixed assets (excluding exchange-listed securities and Japanese government bonds), deferred assets, deposits, short-term loans to affiliates, advances paid, advance payments, securities issued by affiliates, and bonds.

⁵¹ The Risk Management Team is within the C&S Division of OSE’s Market Operations Department and is managed and overseen by the General Manager of the C&S Division. You represent that all persons on the Risk Management Team have sufficient statistical expertise to identify and correct risk management issues and to review and address back testing results.

⁵² A CP may submit written statements in lieu of a hearing.

fail to provide such notice to OSE in a timely manner, OSE could take disciplinary action against the CP (including the suspension of the assumption of obligations or the revocation of the CP's CQ). You note that, in the event of an emergency (*e.g.*, upon the possible failure of the CP), the relevant regulatory authorities would inform OSE directly).

You have represented that, upon the OSE's approval of the acquisition of a CQ, the CP must make a clearing deposit with OSE in order to secure performance of the CP's obligations. Clearing deposit payments are made to OSE in the Exchange's capacity as a "financial instruments clearing organization." Financial instruments clearing organizations have the right to receive payment from clearing deposits in preference over other creditors with regard to claims incurred. OSE manages the clearing deposit for each CP separately from its proprietary resources and other resources of OSE. You have represented that the amount of clearing deposit that OSE requires of a particular CP varies in accordance with the risk involved. CP clearing deposit obligations are calculated by dividing the sum total of the clearing deposit required⁵³ pro-rata by a monthly-averaged margin requirement for each CP. The CP cannot assign, contract to assign, or offer for the purposes of collateral to any other party the right to claim the return of the clearing deposit. If the clearing deposit falls short of the amount required, the CP must deposit with OSE an amount equal to or greater than the shortfall by noon the following day. You represent that the sum total of the clearing deposit required as of December 31, 2010 is ¥61.5 billion (approximately \$728,468,000). The aggregate clearing deposit is reviewed by OSE on a monthly basis.

You have represented further that, after becoming a CP, a firm also must pay a basic fee, pay monthly clearing fees, enter into a CP Agreement, maintain internal rules for the management of positions, and appoint, and register a director or employee to coordinate with OSE and to oversee the CP's operations relating to the settlement and clearing of contracts.

You have represented that OSE possesses the authority to demand that a CP submit reports or other documents regarding the CP's business or property to the Exchange. OSE also maintains the right to inspect the status of the business, property, books, documents and other materials of the CP. The OSE's inspection authority is exercised through regular, on-site examinations of a CP that are conducted by OSE's Participant Affairs (PA) Division once every several years and through special examinations, which are performed by the PA Division on an as-needed basis at the request of the C&S Division. You have represented that such examinations are aimed at discovering the status of the CP's compliance with OSE's Rules, the CP's financial status, the reliability of the CP's performance of its obligations, and for the purpose of ensuring the fairness of futures and options trading on the OSE markets. Regular examinations typically take one or two weeks. You have represented that, during regular CP examinations, OSE inspects the CP's books and records and examines the CP for its management of margin for futures and options trading, customer risk exposure management,

⁵³ OSE calculates its Probable Maximum Loss (PML) on a daily basis and, at the end of each month, designates the highest PML during the prior six month period as the aggregate amount of clearing deposit for the next month. The PML is obtained from the results of stress tests that are conducted every day in accordance with the Lamfalussy standard.

credit exposure management, and sales management. You have represented that OSE reviews, among other things, the CP's internal rules for futures and options trading, customer account ledger, daily trial balance sheet, and status report on margins deposited for futures and options trading. OSE also performs checks to identify inadequacies in the notification of clearing margin requirements. You represent that, if any problems were found in the CP's management of margins from a risk management perspective, the PA Division would notify the C&S Division for appropriate escalation of the matter.

You have represented that OSE retains certain disciplinary authority against a CP that violates applicable rules or requirements or that becomes insolvent. For example, if a CP becomes insolvent and is unable to return easily to solvency, OSE can revoke its CQ. OSE can also revoke a CQ if a CP fails to pay, deliver, or deposit money or securities that it is obligated to pay, deliver or deposit with OSE, other CPs, or TPs that are not CPs. If a CP holds an excessive position in comparison to the status of its property, such as net assets or cash, OSE may raise the amount of clearing margin or clearing deposit required of the CP or take other measures. Such disciplinary matters may be publicly announced by OSE. If the CQ of a CP is suspended (*i.e.*, the assumption of the whole or part of the obligations based on clearable transactions to which the CP is a party is suspended) or revoked, OSE ensures the smooth transition of the unsettled clearing contracts of the CP. For example, OSE may cause the CP to transfer the unsettled clearing contracts to another CP, to settle the transactions, or take other actions OSE may deem necessary.

A CP may withdraw its CQ in accordance with the OSE Clearing Rules, which you represent include procedures for the orderly cancellation of clearing brokerage agreements and the unwinding of open positions or (in the case of a merger) the transfer of open positions.

D. Clearing System

You have represented that the OSE clearing system (OSE-CS) was developed internally by OSE. Users can connect to the OSE-CS through two interfaces – a web-browser interface for human interface⁵⁴ and a direct-connection interface for machine interface.⁵⁵ The execution data and open interest data generated on the J-GATE are interfaced to the OSE-CS on a real-time basis and are synchronized between the systems. You have represented that the OSE-CS includes appropriate security measures, such as authentication of users and data filtering to ensure against unauthorized use and contamination of the system through, *e.g.*, viruses.

With respect to OSE's procedures for ensuring the ongoing reliability of the OSE-CS, you have represented that OSE maintains a business continuity plan. You have represented specifically that each OSE-CS server uses a load balancer to distribute the load. Each OSE-CS server also employs hot-standby configuration consisting of a primary server and a backup

⁵⁴ A web-browser interface uses the services of the OSE-CS by using data display, data input, and file transfer through Microsoft Internet Explorer from a client PC of a user.

⁵⁵ A direct-connection interface uses the services of the OSE-CS by connecting a user's computer system directly to the OSE-CS.

server. You have represented that all key components of the OSE-CS system, including the power supply and all network components, are duplicated. You have represented that OSE maintains geographically separate back-up and disaster recovery sites where data is stored and where clearing and settlement operations could be replicated and resumed in the case of an emergency. The back-up site is located approximately 30 km from the primary site. You have noted that the primary and back-up sites are located on different fault lines, and have explained that any shifts in the fault line that affect the main site are unlikely to affect the back-up site. In addition, the electronic power supply and communication lines for the back-up site are provided and secured separately from the primary site, and you have noted that this may avoid having both sites being affected by the same disaster at the same time.

You have represented that clearing and settlement data is sent to the back-up site in a timely manner and that clearing and settlement functions could be resumed within two hours after the failure occurrence. Operations could be switched to the back-up site within twenty-four hours. You have represented further that OSE conducts annual or more frequent testing of its ability to switch to the back-up site. In addition, when developing a new clearing and settlement function, or when making an adaptation to an existing function that may affect OSE's back-up site, OSE conducts testing of the application subject to development or adaptation, including confirmation that the development or adaptation would have no effect on the whole system. OSE also performs additional testing for performance, capacity, and reliability and the like on a case-by-case basis.

E. Risk Management

You have represented that OSE has established "Risk Management Rules" which specify OSE's risk management procedures. You have represented that the outline of OSE's risk management system was developed jointly by the C&S and Derivatives Business Development Divisions of the Exchange. The detailed operations, procedures, and methods of that system, however, were developed by OSE's Risk Management Team. You have represented further that OSE designates a "person responsible for risk management" at each of its divisions and requires such person to identify the risks at that division, analyze the size and impact of the risks and the probability of occurrence and, based upon the results of the analyses, appropriately respond to those risks.

You have represented that OSE bases its exposure thresholds to individual CPs upon whether an individual CP's position is appropriate in terms of its financial size. OSE recognizes this risk exposure to be "the ratio of possible losses to net assets," which OSE obtains from the results of a stress test for each CP. You have represented that, under normal circumstances, if this ratio were to exceed 50%,⁵⁶ OSE would take certain action to determine whether the CP's position is excessive. Such action would include: (1) checking positions (*e.g.*, OSE would require the CP to report a breakdown of its customer positions, whether any customer had an excessive position, whether a particular position is concentrated with a certain customer, the

⁵⁶ If market volatility becomes extremely high, OSE may change the threshold. In the past, it has changed the threshold to 30%.

status of its clearing margin deposit, etc.); (2) If OSE suspected problems based upon (1), OSE would conduct an inspection of the status of the CP's business, property, books, or other documents or materials; and (3) If the position continues to grow and OSE continues to be concerned after performing (1) and (2), OSE may require an increase of margin deposit or implement other measures, such as issuing a warning or instructing the CP to make improvements to its risk management system. If the CP does not comply with OSE's instructions, OSE may suspend assumption of obligations or revoke the CP's CQ.

You represent that OSE performs stress testing for each CP, taking the Nikkei 225 index as a risk factor and the market volatility during the time period (including the most volatile time periods, such as the fall of Lehman Brothers in 2008 and Black Monday in 1985). Although you define such period as a period under "normal market environments," you believe the required amount can cover an "extreme, but plausible" market environment because you take, in your view, a conservative approach when calculating the PML by including the most volatile periods, setting the confidence level at 99.7%, and adopting the highest value during the past six months (not the value on the day of calculation), as a calculation result.

You have represented that, in order to prevent a CP from holding excessive positions, OSE's Clearing Rules require a CP to establish internal rules to provide for the management of futures and options positions and to submit a copy of such rules to OSE. OSE's Clearing Rules also require a CP to establish the maximum amount of positions that can be held separately for its proprietary account and customer accounts, which amounts must be set at a reasonable level that allows for the positions to be managed in a proper way. OSE's Risk Management Team is responsible for reviewing a CP's internal rules regarding the management of positions initially and upon notification of a new rule or a change to an existing rule. If the Risk Management Team considers the CP's internal rules to be clearly inappropriate for the proper and reliable operation of the CP's financial instruments obligation assumption services, or insufficient to manage positions in an appropriate way (*e.g.*, when the upper limit of positions in futures and options transactions to be held for the CP's proprietary account or for customer accounts is extremely large), OSE may instruct the CP to implement the necessary improvements to its rules. OSE also reviews a CP's overall risk management system, and may require the CP to implement improvements to the system.

F. Settlement Price

You have represented that OSE has specific rules governing settlement prices used for daily mark-to-market and margin calculation for futures and options transactions. Typically, OSE establishes the settlement price for each contract month of stock index futures transactions for each trading day after the close of the day session of the trading day. The settlement price will be the last contract price of stock index futures in a set time period on a trading day specified by OSE. In the event the settlement price is found to be erroneous, OSE may change the price to a value it deems appropriate. In the event a difference arises between the contract price of stock index futures and the settlement price for the trading day on which the contract was executed, the CP pays or receives the difference in cash the following day. The settlement

price rules may vary depending on the specific product. Option settlement prices are determined based upon the option's theoretical value.

G. Margining System

You have represented that OSE has adopted SPAN® as the margin calculation system for futures and option transactions listed for trading on OSE.⁵⁷ You have represented that the margin requirement for futures and options trading on the OSE is calculated by deducting the "Total Amount of Net Option Value" from the "SPAN Requirement," which is the estimate calculated by SPAN® of the largest possible loss an entire portfolio of futures and options contracts could reasonably be expected to experience from one day's market fluctuations, excluding the loss which could be offset by gains arising from each issue in the portfolio. The Total Amount of Net Option Value is intended to cover the risk arising from the exercise of options, etc. and is calculated by deducting the total amount of short option value (short positions × settlement price × trading unit) from that of the long option value (long positions × settlement price × trading unit). The margin requirement is calculated by the software PC-SPAN® using a SPAN Risk Parameter File distributed by OSE every business day. The SPAN Parameter, which is used as the basic factor for calculation of the SPAN Risk Parameter File, is reviewed by the Risk Management Team every week. With respect to the Risk Parameters that OSE expects to cover through its inputs into SPAN, you have represented that the Exchange uses two observation periods, four weeks and twenty-four weeks. OSE adopts the larger one that covers a one-day price move at 99% during the selected observation periods as a risk parameter. You have represented that OSE is able to alter the Risk Parameter on short notice, based upon rapid changes in volatility or to make extraordinary margin calls.

You have represented that OSE back tests its margin by examining how often the actual price movement of OSE's leading contract, the Nikkei 225 futures contract, has exceeded the Price Scan Range in the 250 days prior to the testing day and determining whether such occurrence falls within the scope of the assumption. You represent that such testing is performed on a monthly basis, and was performed eight times during fiscal year 2010.

You have represented that OSE maintains specific rules regarding its margin requirements for futures and options trading. There are two types of margin for a customer's account: (1) "clearing margin" and (2) "brokerage margin." Clearing margin is the margin deposited by a customer with OSE through a CP as agent. If a customer agrees in writing, a CP may instead keep the margin deposited by the customer as "brokerage margin." In the case of brokerage margin, the CP deposits with OSE its own money or securities as clearing margin in place of the customer's money or securities. This is referred to as "substitution of direct deposit." A CP may deposit margin in securities in lieu of cash.⁵⁸

⁵⁷ It monitors price trends and price volatility, and uses this data to determine the appropriate margin levels required and whether extraordinary intra-day margin calls are appropriate.

⁵⁸ As discussed further below, OSE, in the event of a default, may exercise its right to the clearing margin so as to repay the debt pertaining to such default. In addition, a CP, a Non-CP or a customer who is an intermediate broker (a financial instruments dealer who commissions a TP to carry out futures and options trading, acting as an agent)

OSE notifies CPs every day, after accounting for positions, of the respective proprietary account clearing margin requirement for the trading day. A CP is required to notify OSE of the clearing margin requirement for the customers' accounts (*i.e.*, the total of the clearing margin requirements for its customers' accounts and the clearing margin requirement for brokerage for clearing) for the day no later than the time prescribed by OSE.⁵⁹ A Non-CP performing brokerage for clearing is required to notify its designated GCP of the sum total of the clearing margin requirements for its proprietary account and customers' accounts.

When a sale or purchase of a futures contract or a sale of an option contract is concluded for a proprietary account or a customer account, the CP must deposit clearing margin with OSE by noon of the day following the date on which the contract was executed. A CP is required to deposit with OSE all clearing margin submitted by its customer on behalf of the customer. A Non-CP is required to deposit with its designated GCP the clearing margin for its proprietary account and all clearing margin submitted by a customer on behalf of that customer.

If the customer has deposited its margin as brokerage margin, the CP must deposit with OSE its own money or securities as the clearing margin, in an amount not less than the amount deposited with it by the customer. OSE may raise the required amount of margin, if OSE finds that a particular CP holds, or is likely to hold, an excessive position in light of market activities and the CP's financial status.

You have represented that, when there is a deficit in the amount of the clearing margin for a CP's proprietary or customer accounts (the total of the clearing margin for its customers' accounts and for brokerage of clearing) deposited, the CP must deposit the additional clearing margin, in an amount not less than the shortfall, by noon of the day following the occurrence of the shortfall. A customer or a Non-CP conducting brokerage for clearing must deposit with the designated CP acting as its agent the additional margin, in an amount not less than the shortfall, by the time specified by the CP that is no later than noon of the day following the occurrence of the shortfall. Additionally, upon request of OSE, CPs are required to immediately report to OSE in writing the number of customer account positions and other matters relating to customer account futures and options trading, which OSE has deemed necessary for risk management.

You have represented further that OSE also has emergency clearing margin provisions in place. For example, in the event the market for stock index futures has fluctuated beyond the range prescribed by OSE at 11:00 am or OSE has deemed it necessary for any other reason, OSE would impose emergency clearing margins. If, as a result, the clearing margin deposited by a CP for a proprietary account falls below the emergency clearing margin requirements, the CP would

may exercise his or her right to the clearing margin or other margin up to the amount to which each has a claim for return to repay the debt.

⁵⁹ The CP has data on each of its customer's individual positions. OSE does not have that information in the first instance; rather it has information on the CP's total customer position. Accordingly, OSE requires the CP to report to OSE the clearing margin requirement for its customers' accounts, calculated based on each customer's individual position, on a gross basis. In this way, OSE is able to collect customer margin on a gross basis.

be required to deposit additional proprietary account clearing margin with OSE in an amount not less than the shortfall by 4:00 pm on the day on which the emergency clearing margin is called. If this were to occur, OSE would determine the emergency settlement price for each contract.

You have represented further that OSE maintains rules governing a TP's ability to withdraw margin deposits. If the total amount of margin deposited exceeds the margin requirement, a TP may allow the customer to withdraw the money or substitute securities up to the exceeding amount, or the money up to the excess cash amount, whichever is smaller, only if there is still an excess cash margin deposited after the withdrawal (*i.e.*, the amount of money deposited as margin exceeds the amount of money to be paid). Additionally, if an unrealized profit (*i.e.*, a mark-to-market profit) for stock index futures arises in a customer's position and the total amount of margin deposited exceeds the margin requirement, a TP may, upon request by the customer, pay the customer cash equivalent to such unrealized profit up to the exceeding amount.

H. Segregation of Customer Funds

You have represented that, pursuant to the FIEA and OSE's Rules, CPs are required to segregate customer funds and securities from their proprietary funds and securities. Accordingly, a CP must segregate margins for customers' positions from the clearing margins supporting its proprietary positions. OSE sets up a margin account for each CP and manages the margins directly deposited by customers with OSE and substituted margins for customers' accounts separately from the OSE's proprietary and other resources. Similarly, OSE manages CP clearing deposits separately from the proprietary and other resources of OSE.

I. Default Remedies and Procedures

You have represented that OSE maintains rules governing measures to be taken in case of a CP's default. If a CP has failed, or OSE has grounds to believe that it will fail, to settle any of its clearing contracts, OSE will suspend the assumption of the obligations to which the CP is a party. If the CP has failed to settle any of the clearing contracts, OSE may designate another CP and cause such other CP to sell or buy the securities which are required for the settlement of the failed clearing contracts. As discussed in detail below, OSE also maintains provisions for recouping any losses that it suffers as a result of a CP's failure. You have represented that OSE has emergency measures in place in the event that the settlement of clearing contracts has become impossible, extremely difficult due to a natural disaster, an extreme change in the economic situation, a supply shortage, or any other event beyond the control of OSE. In such situations, OSE may stipulate new settlement conditions for the affected contracts.

You represent that, in the event of a CP's default, OSE will recoup losses incurred in accordance with the loss-sharing rules prescribed by OSE. Specifically, OSE will recover such losses in the following order: (1) the clearing margin deposited with OSE for the defaulting CP's proprietary account; (2) the clearing margin to which the defaulting CP has the right to claim the

return;⁶⁰ (3) the clearing deposit deposited with OSE by the defaulting CP; (4) the surplus in any of the accounts described in (1) through (3) after being used according to the purpose of the deposits;⁶¹ (5) other deposits deposited with OSE by the defaulting CP; (6) the guarantee fund of the defaulting CP held by OSE;⁶² (7) the Default Compensation Reserve for Futures and Options Trading (Default Reserve);⁶³ (8) the clearing deposit deposited with OSE by CPs other than the defaulting CP⁶⁴ and the OSE's earned surplus equivalent;⁶⁵ and (9) special dues that OSE requires CPs to pay as of the default date, in the event there are any unrecoverable losses remaining after using the procedures in (1) through (8) above.⁶⁶

You have represented that, as of December 31, 2010, certain relevant amounts include: (1) total clearing margin = ¥581.696 billion (approximately \$6.890 billion); total clearing deposit = ¥84.312 billion (approximately \$998,676,000); total Guarantee Fund = ¥605 million (approximately \$7,166,230);⁶⁷ Default Reserve = ¥7.111 billion (approximately \$84,229,800); OSE's earned surplus equivalent ¥31.173 billion (approximately \$369,244,000). In addition to the foregoing, OSE had approximately ¥130 billion (approximately \$1.540 billion) available to satisfy its liquidity needs as of December 31, 2010. This sum includes approximately ¥26.624

⁶⁰ In the event of a customer default, the CP directly damaged from the default has a right to claim the return of the clearing margin deposited by the defaulting customer with OSE through direct deposit. Where the CP itself defaults, however, the clearing margin deposited by the defaulting customer becomes available to compensate the losses to OSE.

⁶¹ The deposits referenced in (1) through (3) are made for the following purpose: (a) with respect to (1), to ensure the settlement of the loss caused by the defaulting CP's proprietary transactions; (b) with respect to (2), to ensure settlement of the loss caused by the transactions for the defaulting CP's customers' account; and (c) with respect to (3), to ensure settlement to all the unsettled amount of the defaulting CP. If there is any surplus in any of these deposits after being used for the stated purpose, the remaining amount will be used to compensate the loss.

⁶² This refers to the guarantee fund deposited by OSE by a defaulting CP that is also a TP.

⁶³ The Default Reserve is comprised of funds contributed by members to OSE when OSE was a membership organization (*i.e.*, prior to March 31, 2001). After demutualization on April 1, 2001, OSE merged the Default Reserve into its shareholders' equity as part of retained earnings. At a general meeting of OSE members held on February 27, 2001, it was resolved that the Default Reserve could only be used in the event of defaults. Specifically, it may be used to compensate any remaining loss arising from a CP's default that cannot be covered after the funds referenced in (1) through (5) have been used. No contributions will be made to the Default Reserve after it has been appropriated to compensate for loss.

⁶⁴ This means the remaining amount of the reserves that OSE requires to ensure the stable settlement in the case of a CP's default, excluding the deposit made by the defaulting CP (which would have already been used in (3)).

⁶⁵ OSE's earned surplus equivalent is the amount remaining in OSE's retained earnings after deducting funds the purpose of which is determined, such as legal retained earnings, the Default Compensation Reserve for Cash Transactions, the Default Compensation Reserve for Futures and Options Trading in (7).

⁶⁶ In the event that there are any unrecoverable losses remaining after the resources referenced in (1) through (8) are used, OSE will require all CPs, other than the defaulting CP, to pay special dues in proportion. Special dues are intended to compensate loss through the mutual guarantee of CPs, to ensure the stable settlement at OSE as a clearing house.

⁶⁷ The amount of clearing margins, clearing deposits, and guarantee funds are the sum totals of such funds deposited by all CPs or TPs, as applicable, and may not be used in full to compensate the loss arising from a CP's deposit.

billion (approximately \$315,361,000) of OSE's own funds (cash and deposits) and a bank line of credit (¥80billion (approximately \$947,600,000) of overdraft and ¥20 billion (approximately \$236,900,000) of commitment line.

You have represented that the deposit status of margins, guarantee funds, and clearing deposits is monitored by the custody team of the C&S Division through a function of the clearing platform. However, the appropriateness of the required amount of each deposit (except guarantee funds, which have a fixed amount) is monitored by the Risk Management Team.

V. OVERVIEW OF THE REGULATORY STRUCTURE IN JAPAN

A. Introduction

OSE and its TPs are subject to a comprehensive regulatory regime. This regime provides for financial and competency requirements for exchange TPs 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.

B. Applicable Law

The regulatory framework governing OSE is established by the FIEA. The FIEA was enacted in September 2007 by amending and renaming the Securities and Exchange Law and by moving the regulation of the sale and solicitation of financial instruments from its own discrete set of regulations to the broader law which applies generally to all financial instrument firms. The FIEA broadened the scope of existing regulations in order to eliminate the different regulations for financial instruments whose economic functions were identical and was enacted to: establish an over-all single framework for a wide range of financial instruments and services; enhance disclosure requirements; provide organizational structures for the self-regulatory functions of financial instruments exchanges; and increase maximum criminal penalties against market fraud. The FIEA developed a comprehensive definition of a "derivative transaction" to include futures,⁶⁸ forwards, options, swaps and credit derivatives. This new definition greatly expanded the scope of regulated financial instruments and services.⁶⁹

⁶⁸ See FIEA, Chapter 1, Article 2(21)(i), in which futures transactions of "Market Transactions of Derivatives" is defined as "transactions wherein the parties promise to deliver or receive the Financial Instruments or the consideration for them at a fixed time in the future, and when the resale or repurchase of the underlying Financial Instruments are made, settlement thereof may be made by paying or receiving the differences."

⁶⁹ Additionally, the FIEA enhanced disclosure requirements by introducing a quarterly reporting system and internal control reporting system for listed companies. The internal control reporting system is analogous to that of the Sarbanes-Oxley Act in the U.S. For example, quarterly financial statements attached to quarterly reports are subject to audits by certified public accountants or auditing firms and the submission of false quarterly reports is subject to criminal and civil money penalties. Reports evaluating internal controls of financial reporting are mandatory and management must submit a certification stating that the financial statements are appropriate under the FIEA.

In addition, to ensure user protection, secure fairness and transparency of trading and to establish public confidence in the markets, the FIEA increased maximum criminal penalties for misconduct and various market abuses. The criminal penalties for unfair trading, spreading rumors, use of fraudulent means and market manipulation were raised for individuals to possible incarceration for a maximum of 10 years or the assessment of a maximum of ¥10 million (approximately \$118,450) in fines or a combination thereof. Criminal penalties for corporations with dual liability were raised to a maximum fine of ¥700 million (approximately \$8,291,500). The FIEA also imposes civil penalties for making false statements, spreading rumors, trading by fraudulent means, market manipulation and insider trading, where the amount of penalty imposed is to be the amount of the financial benefit received as a result of such misconduct.

The FIEA provides that a financial instruments exchange is required to have in place an appropriate self-regulatory framework and to conduct self-regulation related services which include, among other things, the investigation of TPs with respect to their adherence to laws and regulations, to the exchange rules, or to fair and equitable principles of transactions.⁷⁰ For a financial instruments exchange's self-regulatory committee, such as that established at OSE, independence is crucial and approval by a majority of the directors present at the meeting and a majority of outside directors present is necessary for decision-making. The self-regulatory committee must, among other things, conduct market surveillance, examine TP qualifications, investigate TP compliance with acts or regulations, and examine the listing or delisting of financial instruments and financial indicators or options. Additionally, a self-regulatory committee must develop, amend or abolish exchange rules regarding disciplinary procedures against TPs, as well as other measures regarding self-regulatory operations.

OSE has established a self-regulation committee. By resolution of this committee, OSE may take disciplinary action against TPs violating the laws and regulations, including the revocation of the TP's trading qualification, suspension from or limitation on trading or the handling of customers' orders for up to six months, issuance of a fine of up to ¥100 million (approximately \$1,184,500) for certain violations and up to ¥500 million (approximately \$5,922,500) for severe violations, and issuance of a reprimand.

C. Requirements Applicable to Exchange Operations

Under the FIEA, financial instruments exchanges are required to include detailed provisions within their rules relating to: TPs; kind and period of market transactions of derivatives; starting, ending and suspending market transactions of derivatives; methods of conclusion of a contract for market transactions of derivatives; method of transfer and other settlement for market transactions of derivatives; and other matters necessary for market transaction of derivatives. A financial instruments exchange must also demonstrate that it has sufficient resources to properly manage its operations.

⁷⁰ Financial instruments exchanges can delegate their self-regulatory functions to either a self-regulatory corporation, which is a separate entity specialized for self-regulatory operations and for which the FSA's approval is necessary, or to an independent self-regulatory committee within the same organization.

Additionally, financial instruments exchanges must require that TPs conform to the FIEA and all related laws, regulations and government orders. Specifically, financial instruments exchanges must be operated to achieve the fair and orderly sale and purchase of market transactions of derivatives, as well as to conduct market surveillance and to contribute to the protection of investors. OSE provides that TPs must ensure fair pricing and orderly transition from trading of derivatives to the settlement thereof on the OSE markets, and use their best efforts to preserve and improve the function of the OSE as a financial instruments exchange.

D. Requirements Applicable to Customer Protection

OSE has promulgated rules detailing the requirements of brokerage agreements. The OSE's Brokerage Agreement Standards include conditions for acceptance of orders, methods of settlement, customers' clearing margin requirements, confirmations and various other matters with which customers and TPs must comply.⁷¹ In addition, OSE requires that TPs establish systems which prevent the acceptance and entry of erroneous customer orders. OSE also requires that TPs establish transaction management systems to prevent unfair trading practices in accordance with OSE stipulations. OSE prohibits the abuse of customers' orders, including the practice of trading ahead of customer orders by TPs.⁷² When the OSE department which supervises TPs conducts an inspection, the staff checks the existence and adequacy of the TP's internal control system designed to prevent such abuses and to determine whether such abuses have occurred.⁷³

E. Regulatory Regime Applicable to Clearing and Settlement Functions.

OSE is a "financial instruments clearing organization" that conducts financial instruments obligation assumption services as a business incidental to the establishment of a financial instruments exchange market. A "financial instruments clearing organization" is defined by the FIEA as a person who has been granted a license or approval to operate as such from the Prime Minister of Japan.⁷⁴ You have represented that, as a financial instruments clearing organization, OSE is subject to certain provisions of the FIEA and to oversight by the FSA.

⁷¹ As previously discussed with respect to clearing and clearing margin requirements, customer margin funds must be held in segregation.

⁷² See, Regulations Regarding Fair and Equitable Principles of Trade, Rule 4, Paragraph 1, Item 7 and Rule 3, Item 5 (violation of the fair and equitable principles of transactions). The abuse of customer orders is also prohibited under Article 117 (1) (x), (xi), (xii) and (xxiv) of the Cabinet Office Ordinance regarding the Financial Instruments Business.

⁷³ A TP that is a Type-I Financial Instruments Business Operator is also required to be a member of the Japan Securities Dealers Association (JSDA), an Authorized Financial Instruments Firms Association. The JSDA is a self-regulatory organization which has the authority to promote fair practices and prescribe rules to eliminate unfair trading. The rules and the guidelines prescribed by JSDA require a Type-I Financial Instruments Business Operator to establish an internal control system for preventing the actions prohibited under the FIEA.

⁷⁴ The authority of the Prime Minister to grant a license to operate as a financial instruments clearing organization has been delegated to the Commissioner of the FSA.

You have represented that OSE conducts financial instruments obligation assumption services as a business incidental to the establishment of a financial instruments exchange market by a financial instruments exchange with the approval from the Prime Minister (delegated to the Commissioner of the FSA) pursuant to Article 156-19 of the FIEA. The requirements relating to operation of a financial instruments clearing organization by OSE are continuing in nature and include, among others, the requirements that OSE is not subject to any fines for violating FIEA; that OSE has not had its license rescinded; that none of its directors, officers, accounting advisors, or auditors have been disqualified; that OSE's Articles of Incorporation and rules conform to relevant laws and regulations and are sufficient to conduct its obligation assumption business appropriately and with certainty; that OSE has sufficient financial resources for soundly conducting its clearing business; that the expected income and expenditure pertaining to OSE's financial instruments obligation assumption service is favorable; and that OSE's personnel have the knowledge and expertise to conduct its clearing business.

You further represent that the FIEA mandates that clearing organizations conduct their business pursuant to and enforce their respective rules. Clearing organizations also must submit to the Commissioner of the FSA and receive approval for all rule amendments or changes to their Articles of Incorporation. In addition, clearing organizations are required to notify the Commissioner of the FSA of any change in the clearing organization's stated capital.

You represent that the FIEA requires that the rules of a clearing organization, among other things, set forth the type of transactions that are clearable by the clearing organization, the qualifications of the clearing organization's CPs and other matters related to CPs, matters relating to the novation of transactions and other aspects of the assumption by the clearing organization of the financial obligations of CPs, and matters concerning securing the performance of transactions (*e.g.*, rules related to collateral and the deposit and management of clearing margin). The FIEA also requires that clearing organizations take appropriate measures for securing the clearing of transactions in the event of a CP's default and to stipulate in their rules that, in the first instance, the CP bears all of the loss arising from the assumption service. The FIEA further provides that, if a clearing organization's rules stipulate provisions on the clearing deposit, the clearing organization has the right to receive payment from the clearing deposit in preference over other creditors against a loss caused by the CP's default. If the clearing organization provides for methods of settlements in its rules, such methods continue in effect under the Bankruptcy Act in the event of a default or insolvency of the CP.

In addition, you represent that the FIEA requires that a clearing organization may not unjustly discriminate against any CP. A clearing organization also is required to be a stock company and, therefore, must comply with certain governance requirements applicable to public companies.

You represent that the FIEA authorizes the Commissioner of the FSA to order a clearing organization to submit any reports or materials concerning its property or business to the FSA, to inspect a clearing organization's books and records, and to conduct an on-site inspection of the clearing organization. You further represent that, upon a finding that a provision of the FIEA has

been violated, the Commissioner of the FSA is authorized to rescind a clearing organization's license, suspend the clearing organization from all or part of its business for a period of up to six months, or dismiss any of the clearing organization's officers. The Commissioner of the FSA also has the power to order a clearing organization to take necessary measures for improving its business operations.

Finally, you represent that the FSA participates with other regulators in determining future best practices for clearing houses. For example, the FSA is an active participant in IOSCO. The FSA's Vice Commissioner for International Affairs is currently the Vice-Chairman of the IOSCO Technical Committee.

VI. OSE'S STATUS AS A SELF-REGULATORY ORGANIZATION (SRO)

Under the OSE's Articles of Incorporation, TPs must abide by the FIEA and its related laws and regulations, dispositions given by government agencies based thereon, the OSE's own Articles of Incorporation, Business Regulations, Brokerage Agreement Standards and other rules, and fair and equitable principles of transactions. OSE operates self-regulatory programs and represents that it has a comprehensive rule book requiring that TPs remain in compliance with these requirements and that they, among other things: have adequate capital, employ sound internal management and risk controls, establish transaction management systems, prevent unfair trading, ensure fair pricing, investigate customer qualification, provide OSE with requested information, submit to inspection by OSE staff and register representatives with OSE. In order to carry out these functions, OSE has a staff of over 300 people and various self-regulatory divisions.⁷⁵

OSE rules prohibit TPs from acting "contrary to the fair and equitable principles of transactions." Such actions are defined in the rule as actions that "damage the credibility of OSE or TPs of OSE, or are contrary to good faith in respect to OSE or TPs of the OSE" and include, among others, interfering in or obstructing the business of OSE or its TPs or fraudulent, dishonest or improper activities or gross negligence in administering transaction business. Additionally, OSE has a general requirement that TPs make "best efforts" to preserve and improve the function of the OSE markets. In addition to the rules and regulations already in place, OSE may prescribe additional regulations in relation to the efficient operation of OSE markets. In fulfilling its self-regulatory obligations, OSE conducts real-time and post-trading surveillance and, as discussed below, has the authority to impose sanctions and discipline TPs for violations.

OSE requires its TPs to report to the Exchange in a number of instances. These include activities relating to the authorization or registration to conduct business; issues relating to its process for managing risks of loss; matters relating to suspensions or resumption of business;

⁷⁵ In addition to the Self-Regulation Committee, OSE has a Disciplinary Committee and a Listing Committee as advisory committees to the Self-Regulation Committee, and a number of self-regulatory divisions such as the Self-Regulation Administration Division, the Participant Affairs Division, the Market Surveillance Division and the Listing Administration Division.

issues relating to bankruptcy or insolvency, or the decline of the capital ratio below 140%; when it takes various corporate actions, such as actions affecting voting rights or a change in ownership; when it is subject to questioning, inspection, visit or disciplinary action pursuant to laws or regulations and when it learns that an act in violation of law and regulations or of the Exchange's rules has occurred.

In addition to its authority to discipline TPs for violative conduct, OSE has the authority to address market irregularities. OSE may control trading, for example, by temporarily changing the trading hours prescribed, suspending trading totally or partially, holding a trading session, or cancelling or suspending transactions. OSE also has the authority to take emergency actions, under which, if it considers there is an urgent need, it may impose necessary and appropriate regulations relating to the business of TPs. Additionally, OSE may stipulate new conditions for the settlement of contracts if it determines that the settlement of such contracts has become impossible or extremely difficult due to a natural disaster, extreme change in the economic situation, supply shortage, or any other event beyond the control of OSE.

A. Market and Trade Surveillance

OSE carries out its self-regulatory obligations, in part, through the conduct of real-time and post-trading surveillance. OSE has full-time staff members engaged in the real-time surveillance of futures and options trading on the OSE and additional full-time staff members responsible to carry out post-trade surveillance of futures and options trading. In both real-time and post-trading surveillance, the criteria that result in opening a staff inquiry are formally established in staff guidelines.

In conducting its surveillance of the market, staff makes use of electronic data analysis systems to examine market movements associated with particular trades or to uncover suspicious trading patterns. The activities to be investigated include suspected insider trading, market manipulation and other conduct that appears to violate the laws and regulations thereunder. With respect to possible market manipulation, an investigation may be opened when there appear to be any unusual movements in price and/or trading volume or when there appears to be unusual trading activity apparently relating to a published report or public information or based upon information provided by the public. For insider trading, an investigation may be opened when there appears to be unusual trading activity apparently relating to an entity's publication of material facts, which are required to be published under the FIEA.

In the course of the investigation, staff, among other things, analyzes the movement of the price and trading volume, investigates whether the trading activities are concentrated on a specific TP, and determines whether the case is serious enough to open a more detailed investigation, referred to as an examination. If an examination is opened, staff will, among other things, inquire about and analyze the process of acceptance and execution of orders and the details of the customer and investigate whether corporate insiders have made trades. Ultimately, staff determines whether unfair or inadequate conduct has taken place and decides whether to recommend disciplinary action. If OSE finds the conduct being examined to be contrary to laws, regulations or Exchange rules, OSE takes disciplinary actions, after a hearing, by resolution of

the Self-Regulation Committee.⁷⁶ OSE reports conduct considered to be unfair, inappropriate or inadequate to the Securities and Exchange Surveillance Commission (SESC).⁷⁷

B. Exchange Authority to Address Violative Conduct

OSE, in order to fulfill its self-regulatory functions, has the authority to take disciplinary actions over TPs. OSE may impose fines, order suspensions from or limitations to trading, revoke a party's trading qualification, or issue a formal reprimand. OSE may also issue warnings against actions that are contrary to the laws and regulations. When OSE finds that a TP's internal control system is deficient, it may issue a warning requesting that the TP take corrective action or, as a disciplinary action, it may require the TP to do so. If OSE deems it necessary, it may require the TP to submit periodic improvement reports with respect to the measures taken.

OSE may also take action in the event that, based on the business or financial status of a TP, OSE considers that there is a danger that a violation of the laws and regulations will arise. OSE has the authority to conduct an inspection of the TP and, if the findings of the inspection warrant, issue warnings or take disciplinary action. In addition, if it considers that the business or financial condition of a TP is inappropriate in light of the objectives of OSE or the operation of the OSE markets, OSE may recommend that the TP take specified corrective measures.

C. Regulatory Supervision and Oversight

The Prime Minister has supervisory authority over all financial instruments exchanges in Japan and is authorized to grant licenses to such exchanges and to approve changes in their Articles of Incorporation, Business Regulations, or Brokerage Agreement Standards and the listing of securities issued by financial instruments exchanges or derivatives contracts on such securities. The Prime Minister has delegated these powers, other than the authority to grant licenses to financial instruments exchanges, to the Commissioner of the FSA.

The FSA is responsible for ensuring the stability of Japan's financial system and for protecting investors by, among other things, establishing rules for trading in financial instruments markets, inspecting and supervising market participants and related parties, such as financial instruments exchanges, and surveying compliance of rules in financial instruments markets and for facilitating financial services. The FSA has an authorized staff of up to 1508⁷⁸ and is organized into six major components: the Administrative Law Judge, the Planning and Coordination Bureau, the Inspection Bureau, the Supervisory Bureau, the SESC and the Certified Public Accountants and Auditing Oversight Board.

⁷⁶ The Self-Regulation Committee has been delegated authority by the Board to make decisions on matters relating to the self-regulatory operations of OSE pursuant to the Articles of Incorporation of OSE, and in accordance with the FIEA.

⁷⁷ The SESC, as discussed below, is the component of the FSA which oversees the financial instruments markets.

⁷⁸ The staff number represents the 2010 fiscal year.

The SESC, its authority expanded by implementation of the FIEA, oversees the financial instruments markets. The SESC has a staff of 697 (384 in the main SESC office and 313 in local offices) and is directed by a Chairman and two Commissioners appointed by the Prime Minister with the consent of both houses of the National Diet of Japan.⁷⁹ To encourage their independence when exercising their authority, these officials cannot be dismissed against their will during their three year terms. The SESC's Executive Bureau is composed of five independent divisions: the Coordination Division, the Market Surveillance Division, the Inspection Division, the Civil Penalties Investigation and Disclosure Documents Inspection Division and the Investigation Division.⁸⁰

The SESC conducts the following: daily market surveillance; inspections of market participants and related parties; investigations into criminal cases and accusation thereof; compliance reviews of market intermediaries; examinations of disclosure documents; and investigations into acts suspected to have compromised the fairness of financial instruments trading. The SESC monitors financial instruments markets every day and may require financial instruments business operators to submit detailed reports or materials related to any specific transactions. Where it is convinced after an investigation that further action is appropriate, the SESC may recommend administrative disciplinary actions or file formal complaints with the public prosecutors. Additionally, the SESC is empowered to file motions with the court for prohibition or suspension of acts violating the FIEA.

D. Prohibition of Abusive Market Activities

The FIEA prohibits trading activities that harm market fairness. These include, among others, spreading false rumors, engaging in insider trading, engaging in market manipulation, and engaging in misleading or false transactions. If the FIEA's provisions on unfair trading activities are considered to be violated, the SESC may recommend to the Prime Minister and the Commissioner of the FSA that an order to pay administrative penalties be issued. In addition, the SESC works closely with SROs, particularly self-regulatory departments at financial instruments exchanges. The SESC and SROs share information regarding market oversight and surveillance on issues such as insider trading and transaction management. Additionally, the SESC is authorized to conduct inspections of the SROs to determine if they are carrying out their self-regulatory duties and properly sanctioning their TPs for violations of their rules.

The SESC may submit to the Prime Minister, the Commissioner of the FSA or the Minister of Finance policy proposals, based on the results of SESC market surveillance, inspections or investigations that are considered necessary to ensure fairness in financial instruments transactions or investor protection. For example, if current laws and regulations were found to be insufficient, the SESC would propose reviewing those laws and regulations by presenting specific facts and problems with such laws and regulations.

⁷⁹ The staff number represents the 2010 fiscal year, which is from April 1 to the following March 31.

⁸⁰ The English language web site of the SESC is located at: <http://www.fsa.go.jp/sesc/english/index.htm>.

One of the strongest tools for supervisory enforcement is the Prime Minister's ability to order the financial instruments exchange to dismiss any officer of such an exchange that has violated laws and regulations, the exchange's Articles of Incorporation, or the disposition of any government agency. This also applies to officers of SROs and to members of self-regulatory committees. In addition, the Prime Minister may order a financial instruments exchange, its subsidiary company, or a party that received entrustment of business from the exchange, to produce any information or materials that will be helpful in understanding the operation of its business or its property. This includes inspection authority with respect to operation of the exchange or intermediation business.

Finally, the Prime Minister may order financial instruments exchange to make specific improvements in its operations, rescind its license, or take other disciplinary action. For example, under the FIEA, the Prime Minister may suspend a financial instruments exchange's license for failing to exercise its powers or taking any other necessary measures for enforcing the obligations of its TPs that are in violation of any law or regulation, or for committing an act contrary to the fair and equitable principles of transactions. In addition, if it is found to be necessary and appropriate for the public interest or protection of investors, the Prime Minister may require a financial instruments exchange to undertake certain supervisory measures with regard to compliance with applicable law and regulations.

VII. INFORMATION-SHARING

As described more fully below, the Commission and its staff will be entitled to receive sufficient information regarding OSE, the J-GATE and OSE's market participants directly from OSE pursuant to the terms and conditions of the direct access no-action relief granted herein and existing information-sharing agreements. OSE is a signatory to the Exchange *International Information Sharing Memorandum of Understanding and Agreement* dated March 15, 1996, a framework for over 60 futures exchanges and clearing organizations worldwide to share information relevant to managing global market emergencies.

With respect to government to government information sharing, you represent that the Japanese regulatory authorities have recognized the need for securities regulators to share information on cross-border securities activities, and Japan values international information sharing agreements. In 2002, the FSA, the U.S. Securities and Exchange Commission (SEC) and the CFTC signed a Statement of Intent (SOI) Concerning Cooperation, Consultation and the Exchange of Information, which established a framework for information sharing and facilitated cooperation in investigations of potential unfair cross-border securities activities. The SOI was supported by Notes Verbale, which stated the views the governments share concerning sharing information. In 2006, the FSA and the CFTC signed a document amending the SOI to cover financial derivatives transactions. The SOI now covers both securities derivatives and financial derivatives. Under the new framework, the FSA, SEC and CFTC will, upon request, exchange information regarding financial derivatives markets, including information on financial futures.

In addition, in February 2008, the FSA signed the IOSCO Multilateral Memorandum of Understanding concerning Consultation and Cooperation and the Exchange of Information

(MMOU), a multilateral framework which facilitates information exchanges among securities regulators around the world. Japan underwent a thorough screening process by IOSCO with regard to its legislation concerning information exchange, and IOSCO determined that Japan has the legal ability to undertake the information exchange requirements. By letter dated February 17, 2011, the FSA confirmed that the MMOU and SOI would extend to information requested by the Commission or any Division thereof in connection with trades and activities by TPs of OSE under any direct access no-action relief granted by the CFTC, or any division thereof, with regard to the placement or approval in the U.S. of electronic facilities providing access to OSE.⁸¹

VIII. CONCLUSION

Consistent with the Commission's Policy Statement and the June 2 Order, the Division has reviewed and considered OSE's no-action request and the information and documentation forwarded to the Division in support thereof. Among other things, the materials furnished by OSE indicate that OSE and its TPs are subject to oversight in Japan by a regulatory regime that is based upon regulatory objectives that generally are comparable to those in the U.S.; that the regulatory regime provides basic protections for customers trading on OSE's market and for the integrity of the market itself; that OSE and its regulatory authority employ surveillance, compliance and enforcement mechanisms designed to ensure compliance with statutes and OSE's and the regulatory authority's rules and regulations; that OSE adheres to the IOSCO Principles; and that adequate information-sharing arrangements applicable to the activities of OSE are in place.⁸²

Based specifically upon these and other representations made by OSE in support of its no-action request, the Division has determined that granting no-action relief to OSE and its TPs 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 OSE or its TPs located in the U.S. that have been authorized to directly access the J-GATE solely based upon OSE's failure to obtain contract market designation or DTEF registration pursuant to Sections 5 or 5a, respectively, of the CEA if:

1. OSE TPs trade for their own accounts through the J-GATE (which includes for purposes of this and all subsequent paragraphs, J-NET market transactions which are effectuated through J-GATE) in the U.S.;
2. OSE TPs who are registered with the CFTC as FCMs or who are Rule 30.10 Firms submit orders from or on behalf of U.S. customers to the J-GATE for execution;

⁸¹ Letter from Takashi Nagaoka, Director for International Financial Markets, FSA, to Richard Shilts, Director, Division of Market Oversight, Commodity Futures Trading Commission (February 17, 2011).

⁸² 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 OSE 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.

3. OSE TPs 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 J-GATE; and
4. OSE TPs who are registered with the CFTC as FCMs or who are Rule 30.10 Firms accept orders from U.S. customers transmitted via AORS for transmission to the J-GATE.

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

- MSCI Japan Index Futures Contract
- Russell/Nomura Prime Index Futures Contract
- Mini Nikkei 225 Index Futures Contract
- Nikkei Stock Average Index (Nikkei 225) Futures Contract
- Nikkei 300 Index Futures Contract

If additional futures and option contracts become available for trading through the trading system, OSE may make such futures and option contracts available for trading by direct access 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"⁸³ and (for option contracts) "Notice of Additional Conditions on the No-Action Relief When Foreign Boards of Trade That Have Received Staff No-Action Relief To Permit Direct Access to Their Automated Trading Systems From Locations in the United States List for Trading From the U.S. Linked Futures and Option Contracts and a Revision of Commission Policy Regarding the Listing of Certain New Option Contracts."⁸⁴

The scope of the Division's no-action position is restricted to providing relief from the

⁸³ 71 Fed. Reg. 19877 (April 18, 2006); corrected at 71 Fed. Reg. 21003 (April 24, 2006) ("Notice of Revision"). The Notice of Revision does not apply to broad-based stock index futures and option contracts that are covered by Section 2(a)(1)(C) of the Act. Currently, foreign boards of trade are required under the terms of the no-action relief to seek and receive written supplemental no-action relief from Commission staff prior to offering or selling such contracts through U.S.-located trading systems. See also *Foreign Futures and Options Contracts on a Non-Narrow-Based Security Index; Commission Certification Procedures*, 75 Fed. Reg. 77588 (proposed December 13, 2010) (to be codified at 17 C.F.R. Part 30.13). Additionally, should the Exchange propose to make available pursuant to the no-action relief granted in this letter a contract which settles against any price, including the daily or final settlement price, of (1) a contract listed for trading on a CFTC-registered entity, or (2) a contract listed for trading on an ECM that has been determined to be a significant price discovery contract (linked contract), the Division will impose additional conditions that must be met for the no-action relief to continue in effect for those contracts.

⁸⁴ 74 Fed. Reg. 3570 (Jan. 21, 2009).

requirement that OSE 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 designation and DTEF registration requirements, if the above-referenced contracts are made available in the U.S. for trading through the J-GATE in the manner set forth herein.⁸⁵ 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 OSE or its TPs 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 TP of a foreign board of trade trading solely for its own account) be a registered FCM or a Rule 30.10 Firm.⁸⁶ 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 TP 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

⁸⁵ As previously noted, pursuant to the Dodd-Frank Act, DTEFs are to be eliminated as a class of registrant.

⁸⁶ At this time, the Commission has not issued a Rule 30.10 order to OSE permitting its TPs to conduct brokerage activities on behalf of U.S. persons without having to register as an FCM. However, an OSE TP 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).

AORSs to transmit orders to J-GATE 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 promulgated thereunder. In particular, the no-action position taken herein does not address any issues under the U.S. securities laws that might arise from making the OSE's trading system available in the U.S. through direct access with respect to any security product that is under the jurisdiction of the SEC.

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

1. OSE 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 OSE will continue to require OSE 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. OSE 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 TPs of OSE will have direct access to the trading system from the United States and OSE will not provide, and will take reasonable steps to prevent, third parties from providing such access to OSE to persons other than OSE TPs or those persons authorized by OSE TPs.
5. All orders that are transmitted to the trading system by a TP of OSE that is operating pursuant to the no-action relief provided herein will be solely for the TP's own account unless (i) such TP is registered with the CFTC as an FCM or is a Rule 30.10 Firm, or (ii) such TP 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 OSE TPs through the J-GATE pursuant to the relief granted herein will be intermediated by an OSE CP 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, OSE will require each current and prospective TP that is not registered with the Commission as an FCM, a CTA or a CPO to execute and file with OSE a written representation, executed by a person with the authority to bind the TP, stating that as long as the J-GATE operates pursuant to the no-action relief provided herein, the TP agrees to and submits to the jurisdiction of the CFTC with respect to activities conducted pursuant to the no-action relief. OSE will maintain the foregoing representations as long as the relevant TP is operating pursuant to the no-action relief and shall

make such representation available to the Commission upon the request of a CFTC representative.

8. Prior to their operating pursuant to the no-action relief provided herein, OSE will require each current and prospective TP that is not registered with the CFTC as an FCM, a CTA or a CPO to execute and file with OSE 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.⁸⁷ OSE will maintain the foregoing appointments as long as the relevant TP 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 operating pursuant to the no-action relief provided herein, OSE will require each current and prospective TP of the Exchange that is not registered with the CFTC as an FCM, a CTA or a CPO to file with OSE a written representation, executed by a person with the authority to bind the TP, stating that as long as the TP operates pursuant to the no-action relief provided herein, the TP 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 OSE-TS is installed or used in the U.S. OSE will maintain the foregoing representations as long as the relevant TP is operating pursuant to the no-action relief. OSE 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, OSE will file with the Division, and maintain thereafter as long as OSE 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. OSE 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 the J-GATE 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 OSE generally; and

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

⁸⁷ 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. OSE will request that the FSA provide to the Division not later than July 1st of each year a letter or email confirming that OSE 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. OSE 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;⁸⁸
 - b. Any material change in OSE's Rules or the laws, rules, and regulations in Japan relevant to futures and options;
 - c. Any matter known to OSE or its representatives that, in OSE's judgment, may affect the financial or operational viability of OSE, including, but not limited to, any significant system failure or interruption;
 - d. Any default, insolvency, or bankruptcy of any OSE TP known to OSE or its representatives that may have a material, adverse impact upon the condition of OSE, OSE's clearing function, or upon any United States customer or firm;
 - e. Any known violation by OSE or any OSE TP of the terms or conditions of the no-action relief provided herein; and
 - f. Any disciplinary action taken by OSE against any OSE TP 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 the J-GATE or an AORS to submit orders to OSE and either (1) the OSE TP 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 the J-GATE ; (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. Information-sharing arrangements satisfactory to the Commission will be in effect between the Commission and the Japanese FSA.
15. The Commission will be able to obtain sufficient information regarding OSE and its TPs and CPs operating pursuant to the no-action relief provided herein, and OSE will provide directly

⁸⁸ 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: OSE's TP criteria; the location of OSE's management, personnel or operations (particularly changes that may suggest an increased nexus between OSE'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 OSE.

to the Commission information necessary to evaluate the continued eligibility of OSE, its TPs or CPs 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. registered entities.

16. OSE will employ reasonable procedures, to be determined by OSE, 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 Division or Office of the Commission's staff. It is based upon the information and representations contained in OSE'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 OSE's activities in the U.S. to ascertain whether OSE'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, Senior Special Counsel, at dandresen@cftc.gov or by phone at (202) 418-5492.

Very truly yours,

Richard A. Shilts
Director

Attachment

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

Quarterly Trading Volume Report for Foreign Boards of Trade Granted No-Action Relief (Computed based upon separating buy sides and sell sides).

| 1 | 2 | 3 | 4 | 5 | 6 | 7 |
|----------------------|--|---|----------------------------|------------------------|------------------------------|---|
| Product ¹ | Volume from All Terminals ² | Total Buy/Sell Side Volume (COLUMN 2 X 2) ³ | Volume from U.S. Terminals | | | Percentage from U.S. Terminals ⁷ |
| | | | Buy Side ⁴ | Sell Side ⁵ | Total (4) + (5) ⁶ | |
| Contract 1 | | | | | | |
| Contract 2 | | | | | | |
| Contract 3 | | | | | | |
| Contract 4 | | | | | | |
| Totals | | | | | | |

¹ List each contract that is eligible to be traded by direct access from the U.S., including those contracts for which there was no trading volume during the reporting period.

² Include the total volume worldwide on the electronic trading system for each listed contract and, in the bottom row, enter the total of such volume worldwide for all listed contracts.

³ Multiply Column 2 X 2 (this should represent the total electronic buy side plus the total sell side volume worldwide for each listed contract).

⁴ Include the total electronic buy side volume for each contract originating by direct access in the U.S.

⁵ Include the total electronic sell side volume for each contract originating by direct access in the U.S.

⁶ Add Columns 4 + 5 to represent the total electronic buy side and sell side volume for each contract originating by direct access in the U.S.

⁷ Divide Column 6 by Column 3 and multiply the result by 100 to determine the percentage of the total buy/sell side volume originating from the U.S.