

On the Business and Membership Fee
of the National Futures Protection Fund

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National Futures Protection Fund

I . Business of the National Futures Protection Fund

The National Futures Protection Fund (hereinafter referred to as “the Fund”) carries out its business for preserving customer claims, based on the stipulations of the Commodity Derivatives Act. (About the stipulation, see the attached document No. 1.)

(note) The relevant part of the Act was legislated in line with the Interim Report “On the Reform of the Commodity Futures Market System” adopted on 24. Dec 2003 at the Commodity Futures Exchange Committee of the Industrial Structure Council. (See the attached document No..2.)

The business of the Fund consists of daily business and settlement business.

In carrying out daily business, the Fund supervises its member FCMs (hereinafter referred to as “the members”) by watching their financial situation as well as their fulfilment of segregation duties on the customer assets.

Settlement business is operated typically when a member’s failure occurs. In most cases of failures the member’s properties are exposed to the risk of being seized by general creditors, so it is inappropriate in such cases to let the failed member handle the segregated assets and derived money for paying back to the customers.

Consequently, in order to avoid conflicts with general creditors over segregated assets, the Fund undertakes the settlement and itself performs the procedures in place of the member, except for the cases where obviously no such conflict exists. In order to carry out the settlement procedures, the Fund is authorized to collect money from the segregated assets and to appropriate the money for paying the settlement to the customers, in place of the member.

In this instance, if the money derived from segregated assets falls short of the customer claims, the General Customer Payment is invoked in order to assist the General Customers (if any) to recover the shortage within ¥10 million per customer. This procedure is carried out by the Fund, together with the settlement procedure using the segregated assets.

However, since the Fund was established in 2005, no case has occurred in which the

General Customer Payment was carried out.

(See note1 to 2-(4))

As described above, the Fund operates its daily business and settlement business to protect the interests of all customers (including those under indirect consignments) of the members, not only the customers eligible for the General Customer Payment, but also those ineligible for it, such as institutional or large customers.

The sequence of the Fund's business is as follows.

1. Daily Business

(1) Watching and auditing the members in their finance

The Fund daily watches the members' financial situation by examining and analyzing monthly reports and other information submitted by them, and when necessary carries out on-site inspections.

(2) Supervising the members in their fulfilment of segregation duty

The Fund identifies and checks the customer's assets subject to preservation by examining and analyzing daily reports submitted by the members through CFEF system, and when necessary carries out on-site inspections.

(note) The CFEF is the electronic information system originally developed by the Fund, and it admits JCCH to use this system.

The preservation measures on the customers' assets must be taken in one or more ways chosen from the following 4 methods.

- ① money deposit to the Fund
- ② trust with a financial institution
- ③ guarantee by a bank
- ④ subrogation contract with the Fund (hereinafter referred to as "Fund Subrogation")

(note1) The source of the Fund Subrogation is the subrogation reserve of the Fund. The current balance of the subrogation reserve is ¥4,000,000.

(note2) The contract amount of Fund Subrogation for each member is set by the subrogation contract, in consideration of the member's net amount of customer liabilities, within the upper limit of ¥1,500 million per member.

The Fund's current total of the contracted amount is ¥6,150 million.

(3) Accepting the money deposits from the members

The Fund accepts and pays out the money deposited by the members through joint use of the JCCH system, as one of the measures for segregation.

2. Settlement Business

(1) Classification of Settlement Cases

When a member has gone into the prescribed condition such as bankruptcy, default at an Exchange or closure of business, the Fund classifies the case into one of the following 3 categories, in accordance with its difficulty of settlement.

(a) Voluntary Settlement Case

In this case, the member is regarded capable of voluntarily settling the customer liabilities, for it has properties that are free from conflicts with general creditors, enough to settle all the customer liabilities. The member's own properties and its deposit of segregated assets (other than bank guarantee and Fund Subrogation) can be appropriated for the settlement.

(b) Segregation Settlement Case

In this case, total value of the member's segregated assets (including bank guarantee and Fund Subrogation) is estimated enough to settle all the customer liabilities.

(c) Incapable of Settlement Case

In this case, total value of the member's segregated assets (including the bank guarantee and Fund Subrogation) is not enough to settle all the customer liabilities, and therefore the General Customer Payment may be necessary to be implemented.

(2) Operation for a Voluntary Settlement Case

The Fund gives approval to the member's settlement plan and supervises the member in carrying out voluntary settlements with the customers.

(3) Operation for a Segregation Settlement Case

The Fund collects money from the segregated assets and with that money, settles in place of the member the liabilities with the customers.

In this case the customer claims are entirely covered by the settlement, and regardless of their attributes (i.e. the General Customer or not), all the customers receive full settlement.

(note) In a Segregation Settlement Case that once occurred, a large customer was paid back all his claim of ¥100 million through the Fund Subrogation.

Thus, Fund Subrogation can be an advantageous system for overseas customers, large customers and other customers who are ineligible for the General Customer Payment.

(4) Operation for an Incapable of Settlement Case

The Fund collects money from the segregated assets and with that money, settles in place of the member the liabilities with the customers.

This case being an Incapable of Settlement Case, the recovering percentage with this procedure does not reach 100%. Therefore the Fund makes settlement payments with the money from the segregated assets at a fixed rate, proportionately to the customer liabilities.

However, if General Customers are found involved in the case, they are eligible for receiving the General Customer Payment for the uncovered amount of their claims, within the limit of ¥10 million per customer.

Thus, the Fund distinguishes General Customers and non-General Customers, and pay the calculated amount for each customer.

(note1) A General Customer is defined as the customer whose trades are dealt with by an FCM's office in Japan, and who have consigned to the FCM trade at a Commodity Exchange.

Regardless of the definition above, the qualified institutional investors (as defined in the Financial Instruments and Exchange Act) are excluded from the General Customers. Among others, individuals or a corporations who hold securities valued ¥1,000 million or more are regarded as the qualified institutional investors.

(note2) The source of the General Customer Payment is the Customer Protection Fund (hereinafter referred to as "CP Fund") that the Fund administers, the

current balance being ¥9,850 million.

II The Fund's Imposition of Fees

1. Membership Fee

The Fund annually imposes membership fees on the members, consisting of the fee of fixed amount and that at fixed rate with traded volume, to cover the expenses for its daily business (watching the members' finance, managing the segregated assets, etc.) and settlement business (segregation settlements, General Customer Payments, etc.) etc.

In imposing the membership fee, the Fund makes no differentiation in accordance with the attribute of the customers (i.e. General Customers or not) that each member deals with, because the Fund does its business for the benefit of all customers, not limited to the General Customers.

2. Obligation Fee

When the balance of the CP Fund falls short of the maintenance level of ¥9,800 million, the Fund imposes obligation fees on the members to replenish the CP Fund within 4 years. (See the attached document No. 3.)

The obligation fees are imposed on the following basis.

- (a) 10% of the required replenishment is imposed on the basis of "fixed amount for each member".
- (b) 20% of the required replenishment is imposed on the basis of "proportionate to the business income of each member".
- (c) 20% of the required replenishment is imposed on the basis of "proportionate to the number of customers holding open positions of each member".
- (d) 50% of the required replenishment is imposed on the basis of "proportionate to the traded volume of each member"

(note1) This way of calculation was adopted in February 2012. Before that date obligation fees were to be decided at fixed rate with traded volume, the same way as that of membership fees at fixed rate. However, this system was changed to the current one, reflecting the opinion that the same treatment should not be taken on the eligible and the non-eligible customers for the General Customer Payment.

(note2) Since the Fund was established, no obligation fee has been imposed yet.