

## New Regulation on Commodity Derivatives

**1. License for Commodity Derivatives Business**

Japan's new Commodity Futures and Exchange Act (the "CFEA") becomes effective January 1, 2011, renaming and substantially amending the current Commodity Futures Exchange Act. The CFEA significantly changes current laws and regulations. After the effective date, a person conducting any business categorized as "commodity futures business" (defined in the CFEA; see Section 2 below) must obtain a license in advance. Failure to do so may result in a criminal penalty imposed both on the individuals involved in conducting *commodity futures business* and their company.

Firms currently dealing in commodity derivatives could become subject to licensing requirements for the first time. In particular, brokerage of commodity futures on overseas exchanges and certain categories of over-the-counter derivative transactions, which currently do not require any license, will be subject to the CFEA licensing requirement. No grandfather clause exists. Accordingly, you should confirm whether any of your business falls within *commodity futures business* and, if so, obtain the relevant license.

Upon obtaining a license for *commodity futures business*, you will be regulated by the Japanese authorities<sup>1</sup> and will be subject to rules of conduct and ongoing obligations (e.g., to maintain a minimum net worth ratio, maintain business records and submit monthly reports) under the CFEA. To avoid such requirements, you should restructure your commodity derivatives business such that you can enjoy an exemption. Please note, however, certain exempted OTC commodity derivative business not requiring a license nonetheless falls within "specified OTC commodity derivative business" (defined in the CFEA; see Section 3 below), and a person who conducts such business will be subject to certain regulations and must submit prior notification.

**2. Commodity Futures Business and Exemptions**

The following actions or services "conducted as business"<sup>ii</sup> fall within the category of *commodity futures business* under the CFEA and need a license:

- Acting as intermediary, brokerage or agency for commodity derivatives listed on domestic and overseas exchanges; and
- Entering into OTC commodity derivative transactions (e.g., forward, swap, option and swaption transactions) as a principal, or acting as intermediary, brokerage or agency for OTC commodity derivative transactions.

However, for *commodity futures business* regarding OTC commodity derivative transactions there are broad exemptions from the license requirement, as follows:

- (i) If you limit your customers to the categories of exempted customers listed below, you may conduct OTC commodity derivatives business without a license; and
- (ii) If you conduct OTC commodity derivatives business lawfully in a jurisdiction other than Japan, you may enter into OTC commodity derivatives with Japanese customers (other than individuals) without a license, provided that (a) you must enter into the transactions only from outside of Japan and through an intermediary or agent properly licensed to conduct *commodity futures business*, and (b) no solicitation to such customers may be undertaken.

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Exempted Customers:

- 1) *Commodity futures business* license holders
- 2) Commodity investment advisory business operators (defined in the Act on the Regulation of Commodities Investment Business)
- 3) Qualified institutional investors (defined in the Financial Instruments and Exchange Law (the “FIEL”))
- 4) Financial instruments business operators engaged in type I financial instruments business (defined in the FIEL)
- 5) Registered financial institutions (defined in the FIEL)
- 6) Foreign persons equivalent to persons specified in any of items 1 through to 5 above
- 7) Joint stock companies under Japanese law and equivalent companies under foreign law whose stated capital amount is one billion yen (or equivalent in a foreign currency) or more
- 8) Specified purpose companies (*tokutei mokuteki kaisha*) under the Act on Securitization of Assets which meet certain conditions
- 9) Subsidiaries of a person falling under any of items 1 through to 8 above
- 10) “A party with which the party has close connection” as stipulated in Article 1-4 of the Enforcement Regulations of the CFEA (which is meant to exclude transactions conducted between group companies, and transactions between their traders for certain hedging purposes).

**3. Specified OTC Commodity Derivatives Business**

Where customers fall within the foregoing list and an exemption to the licensing requirement therefore applies, if the underlying assets are commodities or commodity indices listed on a Japanese exchange, or commodity indices similar to listed indices, you will nonetheless be subject to a prohibition of loss compensation, obligations to prepare and maintain business records, supervision by the competent Ministries, and a requirement of pre-notification regarding your business. Regarding maintenance of books, you may keep them in English.

**4. Preparation for Permission**

You may submit an application for a license regarding *commodity futures business* under the CFEA even before its effective date, i.e., January 1, 2011.<sup>iii</sup> According to an October 15, 2010 press release issued jointly by the competent Ministries titled “Acceptation of an Application for License for Commodity Futures Business”, in order to obtain a license on or before January 1, 2011 you must submit a draft notification including attachments (listed in the CFEA) and consult with the competent Ministries by November 17, 2010.

As the effective date is approaching, it is necessary to examine and confirm the commodity derivatives transactions you have been carrying out. If a license is required under the CFEA, prompt action is absolutely necessary.

<sup>i</sup> The Ministry of Economy, Trade and Industry (METI) and the Ministry of Agriculture, Forestry and Fisheries (MAFF).

<sup>ii</sup> Responding to public comments concerning the proposed cabinet ordinance under the CFEA, METI published a statement dated September 10, 2010 indicating that “conducting as business” requires repetitiveness and continuity of the business and does not include proprietary transactions, but that in general this is to be determined on a case-by-case basis.

<sup>iii</sup> If prior application is made before the effective date, license will be deemed to be granted until the competent Ministers’ further action to grant or reject the license.

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