

COMMODITY FUTURES TRADING COMMISSION

17 CFR Part 41

RIN 3038 AB86

SECURITIES AND EXCHANGE COMMISSION

17 CFR Part 240

[Release No. 34- ; File No. S7-]

RIN 3235-AJ54

Joint Proposed Rules: Application of the Definition of Narrow-Based Security Index to Debt Securities Indexes and Security Futures on Debt Securities

AGENCIES: Commodity Futures Trading Commission and Securities and Exchange Commission.

ACTION: Joint proposed rules.

SUMMARY: The Commodity Futures Trading Commission ("CFTC") and the Securities and Exchange Commission ("SEC") (together, the "Commissions") are proposing to adopt a new rule and to amend an existing rule under the Commodity Exchange Act ("CEA") and to adopt two new rules under the Securities Exchange Act of 1934 ("Exchange Act"). These proposed rules and rule amendments would exclude from the definition of "narrow-based security index" debt securities indexes that satisfy specified criteria. A future on a debt securities index that is excluded from the definition of "narrow-based security index" would not be a security future and could trade subject to the exclusive jurisdiction of the CFTC. In addition, the proposed rules would expand the statutory listing standards requirements to permit security futures to be based on debt securities, including narrow-based security indexes composed of debt securities.

DATES: Comments must be received on or before [insert date 30 days after date of publication in the Federal Register].

ADDRESSES: Comments should be sent to both agencies at the addresses listed below.

CFTC: Comments may be submitted, identified by RIN 3038 AB86, by any of the following methods:

- Federal eRulemaking Portal: <http://www.regulations.gov>. Follow the instructions for submitting comments.
- E-mail: secretary@cftc.gov. Include "Application of the Definition of Narrow-Based Security Index to Debt Securities Indexes" in the subject line of the message.
- Fax: 202/418-5521.
- Mail: Send to Jean A. Webb, Secretary, Commodity Futures Trading Commission, Three Lafayette Centre, 1155 21st Street, NW, Washington, DC 20581.
- Courier: Same as Mail above.

All comments received will be posted without change to <http://www.cftc.gov>, including any personal information provided.

SEC: Comments may be submitted by any of the following methods:

Electronic comments:

- Use the SEC's Internet comment form <http://www.sec.gov/rules/proposed.shtml>;
- or
- Send an e-mail to rule-comments@sec.gov. Please include File Number S7- _____ on the subject line; or

- Use the Federal eRulemaking Portal (<http://www.regulations.gov>). Follow the instructions for submitting comments.

Paper comments:

- Send paper comments in triplicate to Nancy M. Morris, Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090.

All submissions should refer to File Number S7-_____. This file number should be included on the subject line if e-mail is used. To help us process and review your comments more efficiently, please use only one method. The SEC will post all comments on the SEC's Internet Web site (<http://www.sec.gov/rules/proposed.shtml>). Comments will also be available for public inspection and copying in the SEC's Public Reference Room, 100 F Street, NE, Washington, DC 20549. All comments received will be posted without change; we do not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly.

FOR FURTHER INFORMATION CONTACT:

CFTC: Elizabeth L. Ritter, Deputy General Counsel, at 202/418-5052, or Julian E. Hammar, Counsel, at 202/418-5118, Office of General Counsel; or Thomas M. Leahy, Jr., Associate Director, Product Review, at 202/418-5278, Division of Market Oversight, Commodity Futures Trading Commission, Three Lafayette Centre, 1155 21st Street, NW, Washington, DC 20581

SEC: Yvonne Fraticelli, Special Counsel, at 202/551-5654; or Leah Mesfin, Special Counsel, at 202/551-5655, Office of Market Supervision, Division of Market Regulation, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-6628.

SUPPLEMENTARY INFORMATION:

The Commissions are proposing to add Rule 41.15 and to amend 41.21 under the CEA,¹ and to add Rule 3a55-4 and Rule 6h-2 under the Exchange Act.²

I. Introduction

Futures contracts on single securities and on narrow-based security indexes (collectively, "security futures") are jointly regulated by the CFTC and the SEC.³ The definition of "narrow-based security index" under both the CEA and the Exchange Act sets forth the criteria for such joint regulatory jurisdiction. Futures on indexes that are not narrow-based security indexes are subject to the exclusive jurisdiction of the CFTC. Under the CEA and the Exchange Act, an index is a "narrow-based security index" if it meets any one of four characteristics.⁴ Further, the CEA and Exchange Act provide that, notwithstanding the statutory criteria, an index is not a narrow-based security index if a contract of sale for future delivery on the index is traded on or subject to the rules of a

¹ All references to the CEA are to 7 U.S.C. 1 et seq.

² All references to the Exchange Act are to 15 U.S.C. 78a et seq.

³ See Section 1a(31) of the CEA, 7 U.S.C. 1a(31); Section 3(a)(55)(A) of the Exchange Act, 15 U.S.C. 78c(a)(55)(A).

⁴ The four characteristics are as follows: (1) it has nine or fewer component securities; (2) any one of its component securities comprises more than 30% of its weighting; (3) any group of five of its component securities together comprise more than 60% of its weighting; or (4) the lowest weighted component securities comprising, in the aggregate, 25% of the index's weighting have an aggregate dollar value of average daily trading volume ("ADTV") of less than \$50 million (or in the case of an index with 15 or more component securities, \$30 million). See section 1a(25)(A)(i) - (iv) of the CEA, 7 U.S.C. 1a(25)(A)(i) - (iv); section 3(a)(55)(B)(i) - (iv) of the Exchange Act, 15 U.S.C. 78c(a)(55)(B)(i) - (iv).

board of trade and meets such requirements as are jointly established by rule, regulation, or order of the Commissions.⁵

The statutory definition of "narrow-based security index" was designed primarily for indexes composed of equity securities, not debt securities. For example, while three criteria in the narrow-based security index definition evaluate the composition and weighting of the securities in the index, another criterion evaluates the liquidity of an index's component securities. The liquidity criterion in the statutory definition of narrow-based security index, which is important for indexes composed of common stock, may not be an appropriate criterion for indexes composed of debt securities.⁶ Debt securities generally do not trade in the same manner as equity securities. Accordingly, most indexes comprised of debt securities, regardless of the number or amount of underlying component securities in the index, fall within the definition of narrow-based security index because few debt securities meet the ADTV criterion in the definition of narrow-based security index.

The Commissions believe that it is appropriate to exclude certain debt securities indexes from the definition of "narrow-based security index" using criteria that differ in certain respects from the criteria applicable to equity securities to evaluate whether debt securities indexes are narrow-based indexes. The Commissions believe that using such modified criteria for debt securities indexes are necessary or appropriate in the public interest and consistent with the protection of investors because the criteria recognize the differences between equity and debt and permit security futures to be based on debt

⁵ See Section 1a(25)(B)(vi) of the CEA, 7 U.S.C. 1a(25)(B)(vi); Section 3(a)(55)(C)(vi) of the Exchange Act, 15 U.S.C. 78c(a)(55)(C)(vi).

⁶ Debt securities include notes, bonds, debentures, or evidences of indebtedness.

securities indexes.⁷ In particular, the Commissions believe that the modified criteria addressing diversification and public information about, and market familiarity with, the issuer of the securities underlying a debt securities index would reduce the likelihood that a future on such an index would be readily susceptible to manipulation and thus are more appropriate criteria for debt securities indexes.

For this reason, the Commissions are proposing rules and rule amendments to exclude from the definition of narrow-based security index a debt securities index that meets certain criteria, as described below. A futures contract on such an index would not be a security future and thus would be subject to the exclusive jurisdiction of the CFTC. In addition, the proposed rules and rule amendments would expand the statutory listing standards to permit the trading of security futures based on debt securities. The proposed rules and rule amendments would permit the trading of security futures on single debt securities and on narrow-based security indexes composed of debt securities, subject to the Commissions' joint jurisdiction. Futures on debt securities indexes that satisfy the criteria of the proposed exclusion would be subject to the exclusive jurisdiction of the CFTC. Although broad-based debt securities indexes that meet the criteria in the proposed rules should have a reduced likelihood of being readily susceptible to manipulation, such indexes must also be determined to be not readily susceptible to manipulation in accordance with Section 2(a)(1)(C)(ii)(II) of the CEA.

⁷ See 15 U.S.C. 78mm(a)(1).

II. Proposed Rules Excluding Certain Debt Securities Indexes from the Definition of Narrow-Based Security Index

The Commissions are proposing that a debt securities index that satisfies the specified criteria would not be considered a narrow-based security index for purposes of Section 3(a)(55) of the Exchange Act and Section 1a(25) of the CEA.

The proposed criteria specify:

- The type of security that may be in the index;
- The maximum weighting and concentration of securities of any issuer in the index;
- Eligibility conditions regarding the issuer of any security in the index that is not an exempted security under the Exchange Act; and
- The minimum remaining outstanding principal amount of the security in the index.

The exclusion also would provide a de minimis exception from certain of the criteria regarding the issuer eligibility and minimum outstanding remaining principal amount conditions if a predominant percentage of the securities comprising the index's weighting satisfied all the applicable criteria.

The proposed rules also contain a definition of "control" solely to assess affiliation among issuers for purposes of determining satisfaction of the criteria.

Under proposed Rule 41.15 under the CEA and proposed Rule 3a55-4 under the Exchange Act, an index would not be a narrow-based security index if the index satisfied the criteria described below.

A. Index composed solely of debt securities

Accordingly, the Commissions' proposed exclusion from the definition of "narrow-based security index" would require that each component security of the index be a security⁸ that is a note, bond, debenture, or evidence of indebtedness.⁹ Further, none of the securities of an issuer included in the index could be an equity security, as defined in Section 3(a)(11) of the Exchange Act and the rules adopted thereunder.¹⁰ Thus, any security index that includes an equity security would not qualify for the proposed exclusion for indexes composed of debt securities.¹¹ The Commissions request comment on the proposed types of securities that could be included in a debt securities index under this exclusion. The proposed rule and rule amendments are intended to establish criteria for determining the circumstances in which a debt securities index is not a narrow-based security index.

B. Number and weighting of index components

⁸ The term "security" is defined in Section 2(a)(1) of the Securities Act of 1933, 15 U.S.C. 77b(a)(1) (the "Securities Act"), and Section 3(a)(10) of the Exchange Act, 15 U.S.C. 78c(a)(10).

⁹ See proposed Rule 3a55-4(a)(1) under the Exchange Act and proposed Rule 41.15(a)(1) under the CEA. The federal securities laws do not contain a single definition of debt security. The Commissions, therefore, are using the terms found in the Trust Indenture Act of 1939 [15 U.S.C. 77aaa - bbb] (which governs debt securities of all types) to define the debt securities for purposes of the proposed rule and rule amendments.

¹⁰ 15 U.S.C. 78c(a)(11). See proposed Rule 3a55-4(a)(2) under the Exchange Act and proposed Rule 41.15(a)(2) under the CEA. A security convertible into an equity security is an equity security under the Exchange Act and the Securities Act.

¹¹ Indexes that include both an equity and debt security or securities would be subject to the criteria for narrow-based security indexes enumerated in Section 1a(25) of the CEA and Section 3(a)(55) of the Exchange Act.

The proposed exclusion also would include conditions relating to the minimum number of securities of non-affiliated issuers that must be included in an index and the maximum permissible weighting of securities in the index for the index to qualify for the exclusion from the definition of "narrow-based security index." Specifically, the debt securities index would have to satisfy each of the following conditions regarding the number and weighting of its component securities:

- the index must be comprised of more than nine securities issued by more than nine non-affiliated issuers;¹²
- the securities of any issuer cannot comprise more than 30% of the index's weighting;¹³ and
- the securities of any five non-affiliated issuers cannot comprise more than 60% of the index's weighting.¹⁴

The foregoing proposed conditions are virtually identical to the criteria contained in the Exchange Act and the CEA that apply in determining if a security index would not be a narrow-based security index.¹⁵ In addition, the proposed rules would provide that the term "issuer" includes a single issuer or group of affiliated issuers. An issuer would be affiliated with another issuer for purposes of the proposed exclusion if it controls, is controlled by, or is under common control with, that other issuer. The proposed rules would define control solely for purposes of the exclusion to mean ownership of 20% or

¹² See proposed Rule 3a55-4(a)(3) under the Exchange Act and proposed Rule 41.15(a)(3) under the CEA.

¹³ See proposed Rule 3a55-4(a)(4) under the Exchange Act and proposed Rule 41.15(a)(4) under the CEA.

¹⁴ See proposed Rule 3a55-4(a)(5) under the Exchange Act and proposed Rule 41.15(a)(5) under the CEA.

¹⁵ See supra note 4.

more of an issuer's equity or the ability to direct the voting of 20% or more of an issuer's voting equity. While the definition of affiliate under the federal securities laws is generally a facts and circumstances determination based on the definition of affiliate contained in such laws,¹⁶ certain rules under the Exchange Act contain a 20% threshold for purposes of determining a relationship between two or more entities.¹⁷ The definition of control would apply solely to the proposed rules and is designed to provide a clear standard for determining control and affiliation for purposes of the proposed exclusion. The proposed rules make clear that for purposes of weighting, all the debt securities of all affiliated issuers included in the index would be aggregated so that the index is not concentrated in securities of a small number of issuers and their affiliates.

The number and weighting criteria would require that an index meet minimum diversification conditions with regard to both issuers and the underlying securities and, therefore, the Commissions believe that these criteria would reduce the likelihood that a future on such a debt securities index would be too dependent on the price behavior of a component single security, small group of securities or issuers or their affiliates. The Commissions request comment on the above proposed criteria. In particular, the Commissions request comment on whether the proposed number and weighting criteria that are essentially the same as for equity security indexes would provide for sufficient diversification of the index with respect to both the securities and the issuers. The Commissions request comment on whether different number or weighting criteria would

¹⁶ See, e.g., Rule 405 under the Securities Act [17 CFR 230.405] and Rule 12b-2 under the Exchange Act [17 CFR 240.12b-2].

¹⁷ See, e.g., Rule 13d-1(c) under the Exchange Act [17 CFR 240.13d-1(c)] and Securities Exchange Act Release No. 39538 (Jan. 12, 1998), 63 FR 2854 (Jan. 16, 1998). See also Rule 3-05 under Regulation S-X [17 CFR 210.3-05].

be appropriate, and request analysis and empirical data regarding the debt market as compared to the equity market to support any suggested modification to the number or weighting criteria. The Commissions also request comment on whether owning 20% of an issuer's equity or the ability to direct the voting of 20% or more of an issuer's voting equity is an appropriate threshold for determining whether there is control of an issuer and therefore affiliation for purposes of the proposed exclusion.

C. Issuer or security eligibility criteria

The proposed criteria would require that for securities that are not exempted securities under the Exchange Act and rules thereunder, such as municipal securities or securities issued by the United States government, the issuer of the component security must satisfy one of the following:

- The issuer must be required to file reports pursuant to section 13 or 15(d) of the Exchange Act;¹⁸
- The issuer must have a worldwide market value of its outstanding common equity held by non-affiliates of \$700 million or more;
- The issuer must have outstanding securities that are notes, bonds, debentures, or evidences of indebtedness having a total remaining principal amount of at least \$1 billion; or
- The issuer of the security must be a government of a foreign country or a political subdivision of a foreign country.

The proposed issuer eligibility criteria are aimed at conditioning the exclusion for a debt securities index from the definition of narrow-based security index on the public

¹⁸ 15 U.S.C. 78m and 78o(d).

availability of information about the issuers of the securities included in the index. For example, an issuer that is required to file reports pursuant to section 13 or 15(d) of the Exchange Act¹⁹ makes regular and public disclosure through its Exchange Act filings. For issuers that are not required to file reports with the SEC under the Exchange Act, the Commissions similarly believe that issuers that have either worldwide equity market capitalization of \$700 million or \$1 billion in outstanding debt are likely to have public information available about them.²⁰ Accordingly, the issuer eligibility criteria should help ensure that, other than with respect to exempted securities in the index, the debt securities index includes debt securities of issuers for which public information is available, thereby reducing the likelihood that an index qualifying for the exclusion would be readily susceptible to manipulation.

The issuer eligibility criteria would not apply if the component security in the index is an exempted security, as defined in the Exchange Act;²¹ or if the issuer of the security is a government of a foreign country or a political subdivision of a foreign country. The Commissions believe that it is appropriate to allow indexes qualifying for the exclusion to include exempted securities and the debt obligations of foreign countries and their political subdivisions. Current law permits futures on individual exempted debt securities, other than municipal securities, and on certain foreign sovereign debt

¹⁹ 15 U.S.C. 78m and 78o.

²⁰ These thresholds are similar to ones the SEC recently adopted in its Securities Offering Reform rules. See Securities Act Release No. 8591 (July 19, 2005), 70 FR 44722 (Aug. 3, 2005).

²¹ See 15 U.S.C. 78c(a)(12). While issuers of exempt securities are not subject to the same issuer eligibility conditions, other existing rules and regulatory regimes applicable to most of such issuers provide for ongoing public information about such issuers. See for example, Rule 15c2-12 under the Exchange Act, 17 CFR 240.15c2-12.

obligations.²² Because a future may be based on one of these exempted debt securities, the Commissions believe that it is reasonable and consistent with the purposes of the CEA and the Exchange Act to allow futures to be based on indexes comprised of such debt securities. The Commissions request comment on the proposed issuer eligibility criteria. If commenters disagree with these criteria, the Commissions request views as to what different or additional criteria would be appropriate that would continue to satisfy the purpose of including securities of issuers for which there is publicly available information. The Commissions also request comment on the exception to the specific issuer eligibility conditions for exempted debt securities, as defined in the Exchange Act, and the debt securities issued by a foreign government or political subdivision of a foreign country that may be included in the debt securities index.

D. Minimum principal amount outstanding

The proposed rules would require that each index component have a total remaining principal amount of at least \$250,000,000. Although trading in most debt securities is limited, trading volume generally increases for debt securities with \$250,000,000 or more in total remaining principal amount outstanding. The proposed criteria do not require that the securities included in the index have an investment grade rating. Nor do the criteria require particular trading volume, due to the generally lower

²² In this regard, Section 2(a)(1)(C)(iv) of the CEA, 7 U.S.C. 2(a)(1)(C)(iv), prohibits any person from entering into a futures contract on any security except an exempted security under Section 3(a)(12) of the Exchange Act, 15 U.S.C. 78c(a)(12), other than a municipal security as defined in Section 3(a)(29) of the Exchange Act, 15 U.S.C. 78c(a)(29). In addition, Rule 3a12-8 under the Exchange Act, 17 CFR 240.3a12-8, deems the debt obligations of specified foreign governments to be exempted securities for the purpose of permitting the offer, sale, and confirmation of futures contracts on those debt obligations in the United States.

trading activity in the debt markets compared to the equity markets. Instead, the Commissions are proposing a minimum principal amount criterion which is intended, together with the other proposed criteria geared to the debt securities market, to provide a substitute criterion for trading volume.²³ Accordingly, the Commissions believe that adopting a minimum remaining principal amount criterion, together with the other proposed criteria, would decrease the likelihood that a future on such an index would be readily susceptible to manipulation. The Commissions request comment on the proposed \$250,000,000 minimum principal amount requirement for each security included in an index. Is \$250,000,000 too high or too low for purposes of the proposal? If so, what figure would be more appropriate in light of the intent of the proposals? Commenters should provide empirical facts, data, and analysis supporting any different minimum principal amount.

E. De minimis exception

The proposed exclusion from the definition of narrow-based security index would except an issuer included in a debt securities index from the proposed issuer eligibility and minimum outstanding principal balance criteria for securities of an issuer if:

²³ Based on data obtained from the Trade Reporting and Compliance Engine (TRACE) database supplied by the National Association of Securities Dealers, Inc., in the debt securities market, trading activity in a debt security generally increases as the principal amount of the debt security increases. It is important to note, however, that generally non-investment-grade debt securities trade more frequently than investment-grade debt securities. Consequently, the Commissions believe that trading volume would not be an appropriate determinant of whether a debt securities index is narrow-based.

- All securities of such issuer included in the index represent less than 5% of the index's weighting;²⁴ and
- Securities comprising at least 80% of the index's weighting satisfy the issuer eligibility and minimum outstanding principal balance criteria.²⁵

The Commissions preliminarily believe that an index that included a very small proportion of securities and issuers that do not satisfy certain of the above criteria should nevertheless be excluded from the definition of narrow-based security index. To satisfy the exclusion, both the five percent weighting threshold and the 80 percent weighting threshold must be met at the time of the assessment. The five percent weighting threshold would ensure that issuers and securities not satisfying certain of the proposed criteria would comprised only a very small portion of the index. The 80 percent weighting threshold would ensure that a predominant percentage of the securities and the issuers in the debt securities index satisfied the proposed criteria. The Commissions believe that the de minimis exception should allow debt securities indexes that include debt securities of a small number of issuers and securities that do not satisfy certain of the proposed criteria to qualify for the proposed exclusion. The Commissions believe that this de minimis exception would provide certain flexibility in constructing an index or determining whether a debt securities index satisfied the proposed exclusion.

²⁴ In determining whether the five percent threshold is met, all securities of an issuer and its affiliates would be aggregated because of the potential for concentrated risk of the index in a limited group of issuers.

²⁵ The 80 percent calculation would be based on the entire index's weighting without subtracting issuers who are not required to satisfy the issuer eligibility criteria and minimum outstanding principal amount criteria. This is important to ensure that a predominant percentage of the index satisfies the proposed criteria.

The Commissions preliminarily believe that the proposed de minimis exception would be appropriate for indexes that are predominantly comprised of securities that satisfy the specified criteria, would be consistent with the protection of investors, and would reduce the likelihood that the index would be readily susceptible to manipulation. The Commissions request comment on the proposed five percent threshold for when the securities of an issuer and its affiliates represent a de minimis proportion of an index. The Commissions also request comment on whether 80 percent represents an appropriate proportion of a debt securities index for purposes of the exclusion. If other thresholds are suggested, please provide empirical data and analysis supporting such other thresholds.

III. Tolerance Period

Section 1a(25)(B)(iii) of the CEA²⁶ and Section 3(a)(55)(C)(iii) of the Exchange Act²⁷ provide that, under certain conditions, a future on a security index may continue to trade as a broad-based index future, even when the index temporarily assumes characteristics that would render it a narrow-based security index under the statutory definition. An index qualifies for this tolerance and therefore is not a narrow-based security index if: (1) a future on the index traded for at least 30 days as an instrument that was not a security future before the index assumed the characteristics of a narrow-based security index; and (2) the index does not retain the characteristics of a narrow-based security index for more than 45 business days over three consecutive calendar months.²⁸

²⁶ 7 U.S.C. 1a(25)(B)(iii).

²⁷ 15 U.S.C. 78c(a)(55)(C)(iii).

²⁸ If the index becomes narrow-based for more than 45 days over three consecutive calendar months, the statute then provides an additional grace period of three months during which the index is excluded from the definition of narrow-based

In addition, Rules 41.12 under the CEA and 3a55-2 under the Exchange Act address the circumstance when a broad-based security index underlying a future becomes narrow-based during the first 30 days of trading. In such case, the future does not meet the requirement of having traded for at least 30 days to qualify for the tolerance period granted by Section 1a(25)(B)(iii) of the CEA²⁹ and Section 3(a)(55)(C)(iii) of the Exchange Act.³⁰ These rules, however, provide that the index will nevertheless be excluded from the definition of narrow-based security index throughout that first 30 days, if the index would not have been a narrow-based security index had it been in existence for an uninterrupted period of six months prior to the first day of trading.

IV. Modification of the Statutory Listing Standards Requirements for Security Futures Products

The Commodity Futures Modernization Act of 2000³¹ amended the Exchange Act and the CEA by, among other things, establishing the criteria and requirements for listing standards regarding the category of securities on which security futures products can be based. The Exchange Act³² provides that it is unlawful for any person to effect transactions in security futures products that are not listed on a national securities exchange or a national securities association registered pursuant to Sections 6(a) or 15A(a), respectively, of the Exchange Act.³³ The Exchange Act³⁴ further provides that

security index. See Section 1a(25)(D) of the CEA, 7 U.S.C. 1a(25)(D), and Section 3(a)(55)(E) of the Exchange Act, 15 U.S.C. 78c(a)(55)(E).

²⁹ 7 U.S.C. 1a(25)(B)(iii).

³⁰ 15 U.S.C. 78c(a)(55)(C)(iii).

³¹ Pub. L. No. 106-554, 114 Stat. 2763 (2000).

³² Section 6(h)(1) of the Exchange Act, 15 U.S.C. 78f(h)(1).

³³ 15 U.S.C. 78f(a) and 78o-3(a).

³⁴ Section 6(h)(2) of the Exchange Act, 15 U.S.C. 78f(h)(2).

such exchange or association is permitted to trade only security futures products that conform with listing standards filed with the SEC and that meet the criteria specified in Section 2(a)(1)(D)(i) of the CEA.³⁵ The CEA states³⁶ that no board of trade shall be designated as a contract market with respect to, or registered as a derivatives transaction execution facility ("DTEF") for, any contracts of sale for future delivery of a security futures product unless the board of trade and the applicable contract meet the criteria specified in that section. Similarly, the Exchange Act³⁷ requires that the listing standards filed with the SEC by an exchange or association meet specified requirements.

In particular, the Exchange Act³⁸ and the CEA³⁹ require that, except as otherwise provided in a rule, regulation, or order, a security future must be based upon common stock and such other equity securities as the Commissions jointly determine appropriate. A security future on a debt security or a debt securities index currently would not satisfy this requirement.

The Exchange Act and the CEA, however, provide the Commissions with the authority to jointly modify this requirement to the extent that the modification fosters the development of fair and orderly markets in security futures products, is necessary or appropriate in the public interest, and is consistent with the protection of investors.⁴⁰

³⁵ 7 U.S.C. 2(a)(1)(D)(i).

³⁶ Section 2(a)(1)(D)(i) of the CEA, 7 U.S.C. 2(a)(1)(D)(i).

³⁷ Section 6(h)(3) of the Exchange Act, 15 U.S.C. 78f(h)(3).

³⁸ Section 6(h)(3)(D) of the Exchange Act, 15 U.S.C. 78f(h)(3)(D).

³⁹ Section 2(a)(1)(D)(i)(III) of the CEA, 7 U.S.C. 2(a)(1)(D)(i)(III).

⁴⁰ Section 6(h)(4)(A) of the Exchange Act, 15 U.S.C. 78f(h)(4)(A); Section 2(a)(1)(D)(v)(I) of the CEA, 7 U.S.C. 2(a)(1)(D)(v)(I).

Pursuant to this authority, the Commissions propose to amend CEA Rule 41.21 and to add Exchange Act Rule 6h-2 to modify the listing standards for security futures to permit the trading of security futures based on debt securities that are notes, bonds, debentures, or evidences of indebtedness and indexes composed of such debt securities. The Commissions note that the Exchange Act⁴¹ requires that the listing standards for security futures products be no less restrictive than comparable listing standards for options traded on a national securities exchange or national securities association. In addition, the CEA and the Exchange Act⁴² provide that the listing standards for a security futures product must require that trading in the security futures product not be readily susceptible to manipulation of the price of such security futures product, nor to causing or being used in the manipulation of the price of an underlying security, option on such security, or option on a group or index including such securities. The Commissions preliminarily believe that the proposed modification to permit the listing of security futures on debt securities and indexes composed of such debt securities would allow the listing and trading of new and potentially useful financial products, while providing the necessary safeguards to ensure that such products are not readily susceptible to manipulation. Therefore, the Commissions believe that the proposed modification would foster the development of fair and orderly markets in security futures products, would be appropriate in the public interest, and would be consistent with the protection of investors. In the absence of this modification, security futures on debt securities and

⁴¹ Section 6(h)(3)(C) of the Exchange Act, 15 U.S.C. 78f(h)(3)(C).

⁴² Section 2(a)(1)(D)(i)(VII) of the CEA, 7 U.S.C. 2(a)(1)(D)(i)(VII); Section 6(h)(3)(H) of the Exchange Act, 15 U.S.C. 78f(h)(3)(H).

indexes composed of such debt securities would continue to be prohibited, thus preventing the development of potentially useful financial products.

V. Request for Comments

The Commissions solicit comments on all aspects of proposed Rule 41.15 and amendments to Rule 41.21 under the CEA and proposed Rule 3a55-4 and Rule 6h-2 under the Exchange Act. Specifically, the Commissions seek comment on whether the proposed rules establish appropriate criteria for identifying debt securities indexes that are not narrow-based and, if not, what other or additional criteria would be appropriate, providing empirical data and analysis supporting any suggestions. Further, the Commissions solicit comment on whether any of the proposed criteria is inappropriate and/or should not be included, also providing detailed analysis and empirical support. In addition, the Commissions seek comment on whether modifying the statutory listing standards to permit security futures based on debt securities and debt securities indexes that are narrow-based would foster the development of fair and orderly markets in security futures products, is necessary or appropriate in the public interest, and is consistent with the protection of investors. Commenters are also welcome to offer their views on any other matters raised by the proposed rules. Commenters should provide empirical data and analysis to support their suggestions.

VI. Paperwork Reduction Act

CFTC:

The Paperwork Reduction Act of 1995 ("PRA"), 44 U.S.C. 3501 *et seq.*, imposes certain requirements on Federal agencies (including the CFTC) in connection with their conducting or sponsoring any collection of information as defined by the PRA. The

proposed rule and rule amendments do not require a new collection of information on the part of any entities.

Accordingly, for purposes of the PRA, the CFTC certifies that the proposed rule and rule amendments, if promulgated in final form, would not impose any new reporting or recordkeeping requirements.

SEC:

Proposed Rules 3a55-4 and 6h-2 would not impose a new "collection of information" within the meaning of the PRA.

VII. Costs and Benefits of the Proposed Rules

CFTC:

Section 15(a) of the CEA requires the CFTC to consider the costs and benefits of its actions before issuing new regulations under the CEA. By its terms, Section 15(a) does not require the CFTC to quantify the costs and benefits of new regulations or to determine whether the benefits of the proposed regulations outweigh their costs. Rather, Section 15(a) requires the CFTC to "consider the cost and benefits" of the subject rules.

Section 15(a) further specifies that the costs and benefits of the proposed rules shall be evaluated in light of five broad areas of market and public concern:

(1) protection of market participants and the public; (2) efficiency, competitiveness, and financial integrity of futures markets; (3) price discovery; (4) sound risk management practices; and (5) other public interest considerations. The CFTC may, in its discretion, give greater weight to any one of the five enumerated areas of concern and may, in its discretion, determine that, notwithstanding its costs, a particular rule is necessary or

appropriate to protect the public interest or to effectuate any of the provisions or to accomplish any of the purposes of the CEA.

The proposed rule and rule amendments should foster the protection of market participants and the public by establishing criteria for futures on broad-based debt securities indexes that should reduce the likelihood that these products would be readily susceptible to manipulation. The statutory listing standards for security futures provide for similar protection of market participants with regard to security futures on narrow-based debt securities indexes and individual debt securities that would be made available for listing and trading pursuant to the proposed rules.

In addition, the proposed rule and rule amendments should encourage the efficiency and competitiveness of futures markets by permitting the listing for trading of new and potentially useful products on debt securities and security indexes. In the absence of the proposed rule and rule amendments, futures on debt securities indexes that meet the proposed criteria for non-narrow-based security index treatment, as well as security futures on narrow-based debt securities indexes and individual debt securities, would be prohibited. Efficiencies should also be achieved because the proposed rules, in establishing criteria for broad-based debt securities indexes, take into consideration the characteristics of such indexes and the issuers of the underlying debt securities that would render joint SEC and CFTC regulation unnecessary. By not subjecting futures on debt securities indexes that meet the proposed criteria to joint SEC and CFTC regulation, the costs for listing such products should be minimized.

The proposed rule and rule amendments should have no material impact from the standpoint of imposing costs or creating benefits, on price discovery, sound risk management practices, or any other public interest considerations.

Although exchanges may incur costs in order to determine whether a debt securities index meets the criteria to be considered broad-based established by the proposed rules, the CFTC believes that these costs are outweighed in light of the factors and benefits discussed above. Accordingly, the CFTC has determined to propose the addition and amendment to Part 41 as set forth below. The CFTC specifically invites public comment on its application of the criteria contained in section 15(a) of the CEA for consideration. Commenters are also invited to submit any quantifiable data that they may have concerning the costs and benefits of the proposed rule and rule amendments with their comment letters.

SEC:

Proposed Rule 6h-2 under the Exchange Act would permit a national securities exchange, subject to certain conditions, to list and trade security futures based on single debt securities and on narrow-based indexes composed of debt securities. Proposed Rule 3a55-4 would exclude from the definition of a narrow-based security index debt securities indexes that satisfy specified criteria. The SEC has preliminarily identified certain costs and benefits relating to proposed Rules 3a55-4 and 6h-2. The SEC requests comments on all aspects of this cost-benefit analysis, including the identification of any additional costs and/or benefits of the proposed rules. The SEC encourages commenters to identify and supply any relevant data, analysis, and estimates concerning the costs and/or benefits of the proposed rules.

A. Benefits

The benefits of proposed Rules 3a55-4 and 6h-2 generally would accrue from expanding the range of securities on which security futures and other index futures may be based. Currently, security futures cannot be based on debt securities or debt securities indexes. The proposed rules and rule amendments would eliminate this prohibition. As a result, the proposed rules and rule amendments would permit a greater variety of financial products to be listed and traded that potentially could facilitate price discovery and the ability to hedge. Investors generally would benefit by having a wider choice of financial products to buy and sell. The measure of this benefit would likely be correlated to the volume of trading in these new instruments. Because security futures based on debt securities would be new products, however, the SEC is unable to quantify these benefits and therefore requests comments, data, and estimates on these benefits.

Proposed Rule 3a55-4 provides criteria that would exclude from the jurisdiction of the SEC futures contracts on certain debt securities indexes. Futures contracts on debt securities indexes that do not meet the criteria in proposed Rule 3a55-4 would be subject to the joint jurisdiction of the SEC and CFTC, while debt securities indexes that meet the criteria for the proposed exclusion would be subject to the exclusive jurisdiction of the CFTC. The SEC requests comments, data, and estimates regarding the benefits associated with allowing the listing and trading of futures on debt securities and narrow-based debt securities indexes under proposed Rule 6h-2 and with the exclusion proposed in Rule 3a55-4.

B. Costs

In complying with proposed Rule 3a55-4, a national securities exchange, national securities association, designated contract market, registered DTEF, or foreign board of trade (each a "listing market") that wishes to list and trade futures contracts based on debt securities indexes would incur certain costs. A listing market that wishes to list and trade such futures contracts would be required to ascertain whether a particular debt securities index was or was not a narrow-based security index, according to the criteria set forth in proposed Rule 3a55-4, and thus whether a futures contract based on that security index were subject to the joint jurisdiction of the SEC and CFTC or to the exclusive jurisdiction of the CFTC. The SEC notes, however, that any such costs replace the current cost of doing the same analysis under the statutory definition of narrow-based security index. Market participants that elect to create debt securities indexes would also incur costs associated with constructing these products. Such costs would be the existing costs of doing business. The SEC requests comment as to the costs that such determinations would impose on listing markets or other market participants. Commenters are encouraged to submit empirical data to support these estimates and to identify any other costs associated with the proposal that have not been considered herein, and what the extent of those costs would be.

VIII. Consideration of Burden on Competition, and Promotion of Efficiency, Competition, and Capital Formation

SEC:

Section 3(f) of the Exchange Act⁴³ requires the SEC, when engaged in a rulemaking that requires it to consider or determine whether an action is necessary or appropriate in the public interest, to consider whether the action would promote

⁴³ 15 U.S.C. 78c(f).

efficiency, competition, and capital formation. Section 23(a)(2) of the Exchange Act⁴⁴ requires the SEC, in adopting rules under the Exchange Act, to consider the impact any rule would have on competition. In particular, Section 23(a)(2) of the Exchange Act prohibits the SEC from adopting any rule that would impose a burden on competition not necessary or appropriate in furtherance of the purposes of the Exchange Act.

The SEC preliminarily believes that proposed Rule 3a55-4 would promote efficiency by setting forth clear methods and guidelines for a listing market to distinguish futures contracts on debt securities indexes that are subject to joint jurisdiction of the SEC and CFTC from futures contracts on debt securities indexes that are subject to the sole jurisdiction of the CFTC.

Proposed Rules 3a55-4 and 6h-2 would lift the ban on the listing and trading of security futures based on debt securities and narrow-based debt securities indexes. Thus, the SEC preliminarily believes that the proposed rules would not have an adverse effect on capital formation.

The SEC preliminarily believes that the proposed rules would not impose any significant burdens on competition. The SEC instead believes that, by allowing listing markets to list and trade new financial products, proposed Rule 6h-2 would promote competition by creating opportunities for listing markets to compete in the market for such products and perhaps for some of these new products to compete against existing products.

⁴⁴ 15. U.S.C. 78w(a)(2).

The SEC requests comments on the potential benefits, as well as adverse consequences, that may result with respect to efficiency, competition, and capital formation if the proposed rules are adopted.

IX. Regulatory Flexibility Act Certifications

CFTC:

The Regulatory Flexibility Act (“RFA”)⁴⁵ requires federal agencies, in promulgating rules, to consider the impact of those rules on small entities. The rules adopted herein would affect contract markets and registered DTEFs. The CFTC previously established certain definitions of “small entities” to be used by the CFTC in evaluating the impact of its rules on small entities in accordance with the RFA.⁴⁶ In its previous determinations, the CFTC has concluded that contract markets and DTEFs are not small entities for the purpose of the RFA.⁴⁷

Accordingly, the CFTC does not expect the rules, as proposed herein, to have a significant economic impact on a substantial number of small entities. Therefore, the Chairman, on behalf of the CFTC, hereby certifies, pursuant to 5 U.S.C. 605(b), that the proposed amendments will not have a significant economic impact on a substantial number of small entities. The CFTC invites the public to comment on this finding and on its proposed determination that the trading facilities covered by these rules would not be small entities for purposes of the RFA.

SEC:

⁴⁵ 5 U.S.C. 601 *et seq.*

⁴⁶ 47 FR 18618-21 (Apr. 20, 1982).

⁴⁷ 47 FR 18618, 18619 (Apr. 20, 1982) (discussing contract markets); 66 FR 42256, 42268 (Aug. 10, 2001) (discussing DTEFs).

Section 603(a)⁴⁸ of the Administrative Procedure Act ("APA"),⁴⁹ as amended by the RFA, generally requires the SEC to undertake a regulatory flexibility analysis of all proposed rules, or proposed rule amendments, to determine the impact of such rulemaking on "small entities."⁵⁰ Section 605(b) of the RFA specifically exempts from this requirement any proposed rule, or proposed rule amendment, which if adopted, would not "have a significant economic impact on a substantial number of small entities." Proposed Rules 3a55-4 and 6h-2 would permit the listing and trading of security futures based on debt securities and establish criteria for excluding certain debt securities indexes from the definition of narrow-based security index. Only markets that are registered with the SEC as national securities exchanges and designated as contract markets or derivatives transaction execution facilities with the CFTC would be making determinations as to the status of the debt securities indexes on which futures contracts are trading. The national securities exchanges⁵¹ and contract markets⁵² that would be

⁴⁸ 5 U.S.C. 603(a).

⁴⁹ 5 U.S.C. 551 et seq.

⁵⁰ Although Section 601(b) of the RFA defines the term "small entity," the statute permits agencies to formulate their own definitions. The SEC has adopted definitions for the term small entity for the purposes of SEC rulemaking in accordance with the RFA. Those definitions, as relevant to this proposed rulemaking, are set forth in Rule 0-10, 17 CFR 240.0-10. See Securities Exchange Act Release No. 18451 (Jan. 28, 1982), 47 FR 5215 (Feb. 4, 1982).

⁵¹ See 17 CFR 240.0-10(e). Paragraph (e) of Exchange Act Rule 0-10 provides that the term "small entity," when referring to an exchange, means any exchange that has been exempted from the reporting requirements of 17 CFR 240.11Aa3-1 and is not affiliated with any person that is not a small entity. Under this standard, none of the exchanges affected by the proposed rule is a small entity.

⁵² The CFTC has previously established certain definitions of "small entities" to be used in evaluating the impact of its rules on small entities in accordance with the RFA. See 47 FR 18618-21 (Apr. 30, 1982). In its previous determinations, the CFTC has concluded that contract markets are not small entities for the purpose of the RFA. See id. at 18619 (discussing contract markets).

subject to the proposed rules are not "small entities" for purposes of the Regulatory Flexibility Act. Therefore, the proposed rules, if adopted, would not have a significant economic impact on a substantial number of small entities for purposes of the Regulatory Flexibility Act.

For the above reasons, the SEC certifies that proposed Rules 3a55-4 and 6h-2 would not have a significant economic impact on a substantial number of small entities. The SEC invites commenters to address whether the proposed rules would have a significant economic impact on a substantial number of small entities, and, if so, what would be the nature of any impact on small entities. The SEC requests that commenters provide empirical data to support the extent of such impact.

X. Consideration of Impact on the Economy

CFTC and SEC:

For purposes of the Small Business Regulatory Enforcement Fairness Act of 1996 ("SBREFA"),⁵³ the SEC and the CFTC must advise the Office of Management and Budget as to whether the proposed regulation constitutes a "major" rule. Under SBREFA, a rule is considered "major" where, if adopted, it results or is likely to result in: (1) an annual effect on the economy of \$100 million or more (either in the form of an increase or a decrease); (2) a major increase in costs or prices for consumers or individual industries; or (3) significant adverse effect on competition, investment or innovation. If a rule is "major," its effectiveness will generally be delayed for 60 days pending Congressional review. The SEC requests comment on the potential impact of the

⁵³ Pub. L. No. 104-121, Title II, 110 Stat. 857 (1996) (codified in various sections of 5 USC, 15 USC, and as a note to 5 USC 601).

proposed rules on the economy on an annual basis. Commenters are requested to provide empirical data and other factual support for their view to the extent possible.

XI. Statutory Authority

Pursuant to the CEA and the Exchange Act, and, particularly, Sections 1a(25)(B)(vi) and 2(a)(1)(D) of the CEA⁵⁴ and Sections 3(a)(55)(C)(vi), 3(b), 6(h), 23(a), and 36 of the Exchange Act,⁵⁵ the Commissions are proposing Rule 41.15 and amendments to Rule 41.21 under the CEA,⁵⁶ and Rules 3a55-4 and 6h-2 under the Exchange Act.⁵⁷

XII. Text of Proposed Rules

List of Subjects

17 CFR Part 41

Security futures products.

17 CFR Part 240

Securities.

Commodity Futures Trading Commission

In accordance with the foregoing, Title 17, chapter I, part 41 of the Code of Federal Regulations is proposed to be amended as follows:

PART 41 – SECURITY FUTURES PRODUCTS

1. The authority citation for part 41 continues to read as follows:

⁵⁴ 7 U.S.C. 1a(25)(B)(vi) and 2(a)(1)(D).

⁵⁵ 15 U.S.C. 78c(a)(55)(C)(vi), 78c(b), 78f(h), 78w(a), and 78mm.

⁵⁶ 17 CFR 41.15 and 41.21.

⁵⁷ 17 CFR 240.3a55-4.

Authority: Sections 206, 251 and 252, Pub. L. 106–554, 114 Stat. 2763, 7 U.S.C. 1a, 2, 6f, 6j, 7a–2, 12a; 15 U.S.C. 78g(c)(2).

* * * * *

Subpart B—Narrow-based Security Indexes

* * * * *

2. Add Section 41.15 to read as follows:

§ 41.15 Exclusion from Definition of Narrow-Based Security Index for Indexes Composed of Debt Securities

(a) An index is not a narrow-based security index if:

(1) Each of the securities of an issuer included in the index is a security, as defined in section 2(a)(1) of the Securities Act of 1933 and section 3(a)(10) of the Securities Exchange Act of 1934 and the respective rules promulgated thereunder, that is a note, bond, debenture, or evidence of indebtedness;

(2) None of the securities of an issuer included in the index is an equity security, as defined in section 3(a)(11) of the Securities Exchange Act of 1934 and the rules promulgated thereunder;

(3) The index is comprised of more than nine securities that are issued by more than nine non-affiliated issuers;

(4) The securities of any issuer included in the index do not comprise more than 30 percent of the index's weighting;

(5) The securities of any five non-affiliated issuers included in the index do not comprise more than 60 percent of the index's weighting;

(6) Except as provided in paragraph (8) of this section, for each security of an issuer included in the index one of the following criteria is satisfied:

- (i) The issuer of the security is required to file reports pursuant to section 13 or section 15(d) of the Securities Exchange Act of 1934;
 - (ii) The issuer of the security has a worldwide market value of its outstanding common equity held by non-affiliates of \$700 million or more;
 - (iii) The issuer of the security has outstanding securities that are notes, bonds, debentures, or evidences of indebtedness having a total remaining principal amount of at least \$1 billion;
 - (iv) The security is an exempted security as defined in the Securities Exchange Act of 1934 and the rules promulgated thereunder; or
 - (v) The issuer of the security is a government of a foreign country or a political subdivision of a foreign country; and
- (7) Except as provided in paragraph (8) of this section, each security of an issuer included in the index has a total remaining principal amount of at least \$250,000,000 except as provided in paragraph (8) of this section.
- (8) Paragraphs (a)(6) and (a)(7) of this section will not apply to securities of an issuer included in the index if:
- (i) all securities of such issuer included in the index represent less than five percent of the index's weighting; and
 - (ii) securities comprising at least 80 percent of the index's weighting satisfy the provisions of paragraphs (a)(6) and (a)(7) of this section.
- (b) For purposes of this section:
- (1) An issuer is affiliated with another issuer if it controls, is controlled by, or is under common control with, that issuer.

(2) Control means ownership of 20 percent or more of an issuer's equity, or the ability to direct the voting of 20 percent or more of the issuer's voting equity.

(3) The term issuer includes a single issuer or group of affiliated issuers.

* * * * *

Subpart C—Requirements and Standards for Listing Security Futures Products

3. Amend Section 41.21 by:

- a. Removing “or” at the end of paragraph (a)(2)(i);
- b. Removing “; and,” at the end of paragraph (a)(2)(ii) and adding “, or” in its place;
- c. Adding paragraph (a)(2)(iii);
- d. Removing “or” at the end of paragraph (b)(3)(i)
- e. Removing “; and,” at the end of paragraph (b)(3)(ii) and adding “, or” in its place; and
- f. Adding paragraph (b)(3)(iii).

The revisions and additions read as follows:

§ 41.21 Requirements for underlying securities

(a) * * *

- (2) The underlying security is:
 - (i) Common stock,
 - (ii) Such other equity security as the Commission and the SEC jointly deem appropriate, or
 - (iii) a note, bond, debenture, or evidence of indebtedness; and,
- (3) * * *

(b) * * *

(3) The securities in the index are:

(i) Common stock,

(ii) Such other equity securities as the Commission and the SEC jointly deem appropriate, or

(iii) a note, bond, debenture, or evidence of indebtedness; and,

(4) * * *

Securities and Exchange Commission

In accordance with the foregoing, Title 17, chapter II, part 240 of the Code of Federal Regulations is proposed to be amended as follows:

PART 240--GENERAL RULES AND REGULATIONS, SECURITIES

EXCHANGE ACT OF 1934

1. The authority citation for part 240 continues to read, in part, as follows:

Authority: 15 U.S.C. 77c, 77d, 77g, 77j, 77s, 77z-2, 77z-3, 77eee, 77ggg, 77nnn, 77sss, 77ttt, 78c, 78d, 78e, 78f, 78g, 78i, 78j, 78j-1, 78k, 78k-1, 78l, 78m, 78n, 78o, 78p, 78q, 78s, 78u-5, 78w, 78x, 78ll, 78mm, 79q, 79t, 80a-20, 80a-23, 80a-29, 80a-37, 80b-3, 80b-4, 80b-11, and 7201 et seq.; and 18 U.S.C. 1350, unless otherwise noted.

* * * * *

2. Section 240.3a55-4 is added to read as follows:

§240.3a55-4 Exclusion from definition of narrow-based security index for indexes composed of debt securities.

(a) An index is not a narrow-based security index if:

(1) Each of the securities of an issuer included in the index is a security, as defined in section 2(a)(1) of the Securities Act of 1933 (15 U.S.C. 77b(a)(1)) and section

3(a)(10) of the Act (15 U.S.C. 78c(a)(10)) and the respective rules promulgated thereunder, that is a note, bond, debenture, or evidence of indebtedness;

(2) None of the securities of an issuer included in the index is an equity security, as defined in section 3(a)(11) of the Act (15 U.S.C. 78c(a)(11)) and the rules promulgated thereunder;

(3) The index is comprised of more than nine securities that are issued by more than nine non-affiliated issuers;

(4) The securities of any issuer included in the index do not comprise more than 30 percent of the index's weighting;

(5) The securities of any five non-affiliated issuers included in the index do not comprise more than 60 percent of the index's weighting;

(6) Except as provided in paragraph (a)(8) of this section, for each security of an issuer included in the index one of the following criteria is satisfied:

(i) The issuer of the security is required to file reports pursuant to section 13 or section 15(d) of the Act (15 U.S.C. 78m and 78o(d));

(ii) The issuer of the security has a worldwide market value of its outstanding common equity held by non-affiliates of \$700 million or more;

(iii) The issuer of the security has outstanding securities that are notes, bonds, debentures, or evidences of indebtedness having a total remaining principal amount of at least \$1 billion;

(iv) The security is an exempted security as defined in the Act and the rules promulgated thereunder; or

(v) The issuer of the security is a government of a foreign country or a political subdivision of a foreign country;

(7) Except as provided in paragraph (a)(8) of this section, each security of an issuer included in the index has a total remaining principal amount of at least \$250,000,000 except as provided in paragraph (a)(8) of this section; and

(8) Paragraphs (a)(6) and (a)(7) of this section will not apply to securities of an issuer included in the index if:

(i) All securities of such issuer included in the index represent less than five percent of the index's weighting; and

(ii) Securities comprising at least 80 percent of the index's weighting satisfy the provisions of paragraphs (a)(6) and (a)(7) of this section.

(b) For purposes of this section:

(1) An issuer is affiliated with another issuer if it controls, is controlled by, or is under common control with, that issuer.

(2) Control means ownership of 20 percent or more of an issuer's equity, or the ability to direct the voting of 20 percent or more of the issuer's voting equity.

(3) The term issuer includes a single issuer or group of affiliated issuers.

3. Section 240.6h-2 is added to read as follows:

§240.6h-2 Security future based on note, bond, debenture, or evidence of indebtedness.

A security future may be based upon a security that is a note, bond, debenture, or evidence of indebtedness or a narrow-based security index composed of such securities.

Dated:

By the Commodity Futures Trading Commission.

Jean A. Webb
Secretary

By the Securities and Exchange Commission.

Nancy M. Morris
Secretary

Dated: