

CFTC Letter No. 00-22

December 9, 1999

No-Action

Office of General Counsel

Philip McBride Johnson, Esq.

Skadden, Arps, Slate, Meagher & Flom LLP

1440 New York Avenue, N.W.

Washington, D.C. 20005-2111

Re: Montreal Exchange Request for No-Action Letter for Futures
Contract based on the S&P/TSE 60 Stock Index

Dear Mr. Johnson:

This is in response to your letters and facsimiles dated from August 4, 1999 through November 30, 1999 requesting that the Office of the General Counsel of the Commodity Futures Trading Commission ("Commission" or "CFTC") issue a "no-action" letter concerning the offer and sale in the United States (the "U.S.") of the Montreal Exchange ("ME") futures contract based on the S&P/TSE 60 Stock Index (the "S&P/TSE 60 Contract").

We understand the facts to be as follows. The ME is a Canadian exchange located in the province of Quebec and is regulated by the Commission des valeurs mobilières du Québec ("CVMQ"). The CVMQ is responsible for the regulation of both the securities and futures markets in Quebec. Specifically, the functions of the CVMQ include supervising and monitoring the activities of exchanges and clearinghouses, including the ME and its affiliate, the Canadian Derivatives Clearing Corporation Limited. The CVMQ operates under and enforces the Quebec Securities Act.

The S&P/TSE 60 Stock Index (the "Index") was created and is maintained by Standard & Poor's ("S&P").¹ The official calculation of the Index is done by Kinetic Information Systems Services, Inc. ("Kinetic"), an independent calculation service, with verification checks by S&P as to the accuracy of Kinetic's value calculation. The Index was created to track the trading activity of the Canadian stock market.² The Index is a market capitalization-weighted index and includes the stocks of 60 constituent companies traded on the TSE. Constituent companies in the Index typically are reviewed on a quarterly basis. The stocks comprising the Index represent 11 industry groups and include the largest capitalized stocks in each industry group having the most liquid securities in the Canadian stock market. The Index represents approximately 65 per cent of total Canadian stock market capitalization. The three largest industries included in the Index are financials (approximately 22 per cent), technology (approximately 15 per cent) and communication services (approximately 13 per cent). As of June 25, 1999, the highest capitalized stock in the Index, Nortel Networks Corporation, represented 11.48 per cent of the Index. The five highest capitalized stocks in the Index accounted for 36.99 per cent of the Index as of the same date and the total capitalization of the stocks included in the Index equaled over C\$536 billion (approximately US

\$359 billion) as of August 31, 1999. The value of the Index is available on a real-time basis, is updated every 15 seconds and is disseminated by recognized market data vendors such as Reuters and Bloomberg.

The S&P/TSE 60 Contract is a cash-settled contract, denominated in Canadian dollars, the value of which is derived by multiplying the Index by C\$200. The futures contract price may fluctuate in minimum increments of .05 Index points, which is the equivalent of C\$10. The position limit for the futures contract is 30,000 net long or short in all contract months combined, and the reporting limits are set at 1,000 contracts net long or short in all contract months combined. The final settlement price for the S&P/TSE 60 Contract is the product derived by multiplying C\$200 by the official opening level of the Index, based on the opening prices of the component stocks in the Index (or the last sale price of a stock that does not open for trading) on the regularly scheduled day of final settlement.³ The S&P/TSE 60 Contract has been trading since September 1999.

The offer and sale in the U.S. of futures contracts traded on or subject to the rules of a foreign exchange is subject to the Commission's exclusive jurisdiction.⁴ Section 2(a)(1)(B)(v) of the Act, 7 U.S.C. § 2a(v) (1994), generally prohibits any person from offering or selling a futures contract based on a securities index except as permitted under Section 2(a)(1)(B)(ii), 7 U.S.C. § 2a(ii) (1994), which sets forth three criteria to govern Commission designation of futures contracts on a group or index of securities:

- (1) the contract must provide for cash settlement;
- (2) the contract must not be readily susceptible to manipulation nor to being used to manipulate any underlying security; and
- (3) the index must be predominately composed of the securities of unaffiliated issuers and reflect the market for all publicly traded securities or a substantial segment thereof.

See H.R. Rep. No. 565, Part 1, 97th Cong., 2d Sess. 39 (1982).

Section 2(a)(1)(B)(ii) also provides that the Commission shall not designate a board of trade as a contract market unless the Commission finds that the board of trade meets the criteria enumerated therein. Although we understand that the ME does not seek designation as a contract market, the House Committee on Agriculture suggested that a foreign board of trade could apply for "certification" that its stock index contract met all applicable Commission requirements. H.R. Rep. No. 565, Part 1, 97th Cong., 2d Sess. 85 (1982). The House Committee on Agriculture explained that a foreign exchange seeking certification for a futures contract based upon an index of U.S. securities must demonstrate that the proposed futures contract meets the requirements set forth in Section 2(a)(1)(B)(ii). Id.

We understand that the securities in the Index are issued by Canadian companies. The House Committee suggested that the Commission may use such criteria as it deems appropriate in evaluating a foreign stock index contract based on "foreign securities." Id. The requirements of Section 2(a)(1)(B)(ii) of the Act were designed to permit futures trading in "broad-based . . . indices that are not conducive to manipulation or disruption of the market for the underlying securities."⁵ Based on the information noted herein and as set forth in the letters, attachments and facsimiles noted above, we have determined that the S&P/TSE 60 Contract conforms to these requirements.

In evaluating requests for no-action relief with regard to foreign futures contracts based on foreign stock indices, the Commission generally examines whether a surveillance sharing arrangement exists between the futures exchange and the securities exchange on which the underlying stocks are traded. In this regard, both the ME and TSE are parties to the Intermarket Surveillance Group ("ISG"). The ISG provides a framework under which

exchanges (including U.S. and Canadian securities and futures exchanges) share information regarding related products and market surveillance. The information that may be shared includes information related to a financial instrument traded through the facilities of a party, a member of a party (including information concerning the identity, trading activity and positions of the party's members or customers of the party's members) or the disposition of a disciplinary action taken by a party against its members, member organization or person associated therewith.⁶

In light of the foregoing, the Office of the General Counsel will not recommend any enforcement action to the Commission based on Sections 2(a)(1)(B)(v), 4(a), or 12(e) of the Commodity Exchange Act, as amended, if the S&P/TSE 60 Contract traded on the ME is offered and sold in the U.S. Because this position is based upon facts and representations contained in the above-noted letters, attachments and facsimiles, it should be noted that any different, omitted or changed facts or conditions might require a different conclusion. This position also is contingent on the continued compliance by the ME with all regulatory requirements imposed by the CVMQ and the applicable statutes of the province of Quebec and Canada.⁷

The offer and sale in the U.S. of the S&P/TSE 60 Contract is, of course, subject to the Part 30 regulations adopted by the Commission to govern the offer and sale of foreign futures and foreign option contracts in the U.S.⁸

Sincerely,

C.
Robert
Paul

General
Counsel

cc: Ms. Annette L. Nazareth

Director

Division of Market Regulation

Securities and Exchange Commission

¹ While the Index is constructed and maintained by S&P, the right to add or remove a component security is vested in the Index Policy Committee, which is a seven-person committee with representatives from S&P and the Toronto Stock Exchange ("TSE"). The committee makes the decision regarding a security's inclusion in the Index based on criteria including market capitalization, liquidity, sector representation and company fundamental data.

² Prior to the trading of the S&P/TSE 60 Contract, the Toronto Futures Exchange ("TFE") TSE 35 Stock Index futures contract was the benchmark stock index product for the Canadian securities market. The CFTC staff issued no-action relief for that futures contract by letter dated October 6, 1988. Under a restructuring agreement between the Canadian investment exchanges, trading in derivative products will be concentrated at the ME. The S&P/TSE 60 Contract will be the successor to the TSE 35 Stock Index futures contract as Canada's benchmark stock index derivative and hedging tool. We understand that the last listed futures contract month on the TSE 35 Stock Index is scheduled to expire on December 17, 1999.

3 The last trading day for the S&P/TSE 60 Contract generally is the trading day prior to the final settlement day of the contract month. The Final Settlement Day is the third Friday of the contract month.

4 The terms "any other board of trade, exchange, or market" in Section 2(a)(1)(A)(i) make clear the Commission's exclusive jurisdiction includes futures contracts executed on a foreign board of trade, exchange or market. Section 2(a)(1)(A), 7 U.S.C. § 2 (1994); 120 Cong. Rec. 34497 (1974) (statement of Senator Talmadge).

5 S. Rep. No. 390, 97th Cong., 2d Sess. 6 (1982). See also H.R. Rep. No. 565, Part 1, 97th Cong., 2d Sess. at 39.

6 See letter dated November 16, 1999 letter from Mr. Johnson to David Merrill, Deputy General Counsel, CFTC.

7 On July 7, 1992, a Memorandum of Understanding ("MOU") was entered into among the CVMQ, the Ontario Securities Commission ("OSC") (the regulator of the TSE and TFE) and the CFTC with respect to the sharing of confidential information among agencies. In addition, the CVMQ entered into a Financial Information Sharing Memorandum of Understanding ("FISMOU") with the CFTC. See FISMOU among the CFTC, CVMQ, OSC, the National Futures Association, ME and TFE signed on September 23, 1991. Also, the CFTC has granted Regulation 30.10 relief to designated members of the ME. See Appendix C to Commission Regulation 30.10, 17 C.F.R. § 30.10. In this connection, the CVMQ has confirmed that the MOU applies to the ME S&P/TSE 60 Contract and that it will cooperate with the CFTC to the full extent permitted under Quebec law. See letter dated November 29, 1999 from Jean Lorrain, Director, Conformité et Application, CVMQ, to Mr. Johnson. Further, the CVMQ is a signatory to the Declaration on Cooperation and Supervision of International Futures Exchanges and Clearing Organizations for the sharing of large exposure information dated March 15, 1996. The ME also has represented that it will cooperate with the Commission in inquiries, investigations, and enforcement proceedings relating to the offer and sale in the U.S. of the ME S&P/TSE 60 Contract on the ME. See letter dated August 4, 1999 from Mr. Johnson to Daniel R. Waldman, General Counsel, CFTC. Finally, the ME also is a signatory to the International Information Sharing Memorandum of Understanding and Agreement signed on March 15, 1996 at Boca Raton, Florida.

8 See 17 C.F.R. Part 30.