

CFTC Letter No. 00-27

March 10, 2000

No-Action

Office of General Counsel

Mr. John Foyle

Deputy Chief Executive

The London International Financial Futures

And Options Exchange

Cannon Bridge House

1 Cousin Lane

London EC4R 3XX

United Kingdom

Re: No-Action Request to Permit the Offer and Sale in the U.S. of Futures Contracts on the FTSE International Limited Eurotop 100 Index Traded on the London International Financial Futures and Options Exchange ("LIFFE")

Dear Mr. Foyle:

This is in response to letters and facsimiles dated from September 29, 1998 through November 9, 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 ("U.S.") of LIFFE's futures contract based on the FTSE International Limited Eurotop 100 Index ("FTSE Eurotop 100" or "Index").¹

We understand the facts to be as follows. The LIFFE is under the regulatory jurisdiction of the Financial Services Authority ("FSA"). The FSA derives its authority from, and implements and

enforces the provisions of, the Financial Services Act of 1986. The Financial Services Act provides comprehensive authority for regulating the financial services industry in the United Kingdom ("U.K."), including principles for market integrity and investor protection.²

The FTSE Eurotop 100 is a broad-based, modified capitalization-weighted composite index of 100 of the most highly-capitalized and actively-traded stocks currently listed on nine major European stock exchanges.³ The total market capitalization of the Index as of October 29, 1999 was U.S. \$3.88 trillion.⁴ Stocks in the Index are diversified over 27 industry sectors, with no sector representing more than 15% of the Index. Stock selection criteria ensure that only the most liquid stocks are included in the Index. As of October 29, 1999, no single stock in the Index represented more than 4.54% of the Index's value, and the five most heavily-weighted stocks accounted for 17.44% of the Index's value. Annual adjustments are made to the selection of stocks and base weightings of countries in the Index. FTSE International calculates the Index in real time and disseminates the Index through electronic media every 15 seconds. The Index also is published daily in major newspapers.

The FTSE Eurotop 100 futures contract has traded on the LIFFE since May 12, 1998. The contract provides for cash settlement. The notional value of the FTSE Eurotop 100 futures contract is determined by multiplying the Index by 20 euros. Prices are quoted in Index points with each Index point equal to 20 euros per contract. Contract delivery months are March, June, September, and December, and the last trading day for the contracts is the third Friday of the month. Cash settlement occurs on the first business day after the last trading day. The final settlement price is derived from the average of the Index values calculated every 15 seconds between 12:40 p.m. and 1:00 p.m. (Central European Time).⁵

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.⁶ 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 LIFFE does not seek designation as a contract market, the Committee on Agriculture of the U.S. House of Representatives ("House Committee") suggested that a foreign board of trade like LIFFE could apply to the Commission for "certification" that its stock index contract conforms with the requirements of the Act established for a specifically identified contract and therefore could be offered and sold in the U.S. H.R. Rep. No. 565, Part 1, 97th Cong., 2d Sess. 85 (1982). The House Committee explained, for example, that a foreign exchange could seek certification from the Commission that its futures contract based upon an index of U.S. securities meets the requirements set forth in Section 2(a)(1)(B)(ii). Id.

As noted above, we understand that the securities in the Index are issued by European companies only. With respect to futures contracts based on such a foreign securities index, the House Committee suggested that the Commission may use such criteria as it deems appropriate to determine whether such futures contracts may be offered and sold in the U.S. Id. In this regard, 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."⁷ Accordingly, we have examined LIFFE's FTSE Eurotop 100 futures contract in light of these criteria. Based on the information noted herein and as set forth in the letters, attachments and facsimiles noted above, we have determined that this futures contract conforms to these requirements.

In evaluating whether a foreign futures contract based on a foreign stock index is not readily susceptible to manipulation or to being used to manipulate any underlying security, this Office inquires whether surveillance-sharing arrangements exist between the requesting futures exchange and the securities exchanges on which the underlying stocks are traded. The FTSE Eurotop 100 contains stocks that are traded on nine European securities exchanges. LIFFE has exchange-to-exchange surveillance-sharing agreements with the stock exchanges in two countries represented in the Index, the U.K. and the Netherlands. In the U.K., LIFFE has signed a regulatory agreement with the London Stock Exchange ("LSE") that provides for the exchange of information regarding the FTSE Eurotop 100 futures contract and component stocks of the Index traded on the LSE. Moreover, in the Netherlands, LIFFE has entered into an information-sharing agreement with the Amsterdam Exchanges. The component stocks covered by these exchange-to-exchange surveillance-sharing agreements represent approximately 43% of the market capitalization of the Index.

In addition, the U.K., as a member of the European Union, is subject to the Investment Services Directive ("ISD"), which sets out the legal basis for the provision of investment services throughout the European Union. The ISD has been implemented into national law by

all members. In the U.K., the FSA is the main competent authority for the ISD's purposes. All of the countries who have stock represented in the Index, except Switzerland,⁸ are subject to the ISD, i.e., Germany, France, the Netherlands, Italy, Spain, Sweden and Belgium. Stocks traded on the securities exchanges in these countries represent 90% of the value of the Index.⁹ LIFFE has represented that the ISD provides a statutory framework for a comprehensive system of cooperation and information sharing among authorities that are responsible for regulating financial services within the European Union.¹⁰ Moreover, LIFFE has represented that through the ISD it can receive information about market trading, clearing activity, and customer identity.¹¹

In consideration of LIFFE's exchange-to-exchange surveillance-sharing agreements and the various bilateral and multilateral information-sharing arrangements to which the U.K. is a party, as noted herein, we have concluded that LIFFE will have sufficient access to the information it may need to detect and deter manipulation. In making this determination, we have considered the diversification, capitalization, and the liquidity of the component securities of the Index. Nevertheless, this Office continues to advocate that exchange-to-exchange surveillance-sharing arrangements are preferable as the most expedient means to obtain the detailed information required for an effective surveillance program to detect manipulation. Therefore, we encourage LIFFE to pursue forging exchange-to-exchange surveillance-sharing agreements for the stocks underlying the Index. In the event that LIFFE is unable to obtain access to adequate surveillance data under the means that it has cited, this Office reserves the right to reconsider the position we have taken herein.¹²

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 FTSE Eurotop 100 Futures Contract traded on LIFFE is offered and sold in the U.S.¹³ Because this position is based upon facts and representations contained in the letters, attachments and facsimiles cited above, 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 LIFFE with all regulatory requirements imposed by the FSA and the applicable laws and regulations of the U. K.

The offer and sale in the U.S. of LIFFE's FTSE Eurotop 100 Futures 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.¹⁴

Yours truly,

C. Robert Paul

General Counsel

cc: Ms. Annette L. Nazareth

Director

Division of Market Regulation

Securities and Exchange Commission

Arthur Hahn, Esq.

Katten Muchin and Zavis

1 See letter from David Wenman, Managing Director, Development, LIFFE, to Harold Hardman, Assistant General Counsel, CFTC, dated September 29, 1998. The Commission designated the Commodity Exchange, Inc. as a contract market in FTSE Eurotop 100 futures and options on June 4, 1992. The Commission also issued a no-action letter regarding the Amsterdam Exchanges' FTSE Eurotop 100 futures contract on May 14, 1996.

2 In addition, the United Kingdom's Department of Trade and Industry and the Serious Fraud Office also play a role to prevent market manipulation and fraud. The Commission staff recently reviewed the regulatory structure in the United Kingdom and the regulation of LIFFE and its members in connection with the relief granted to LIFFE to make available its electronic trading system in the United States. See CFTC Staff Letter No. 99-34, [1998-1999 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 27,744 (July 23, 1999).

3 As of October 29, 1999, the Index includes stocks from the United Kingdom, Germany, France, Switzerland, the Netherlands, Italy, Spain, Sweden and Belgium.

4 See letter from Laurence Walton, Senior Associate, Market Secretariat, LIFFE to Joseph Corcoran, Attorney, Securities and Exchange Commission ("SEC"), dated November 9, 1999.

5 Of the 81 measured values, the highest 12 and the lowest 12 are discarded, and the remaining 57 are averaged to calculate the settlement price.

6 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).

7 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.

8 The U.K. has entered into a bilateral memorandum of understanding with Switzerland, the only country represented in the Index which is not a member of the European Union and thus not subject to the ISD.

9 The FSA also is a member of the Forum of European Securities Commissions ("FESCO"). The members of FESCO have entered into a Multilateral Memorandum of Understanding on the Exchange of Information and Surveillance of Securities Activities, dated January 26, 1999 ("Multilateral MOU"). Regulatory authorities in all of the countries represented in the FTSE Eurotop 100 Index except Switzerland are parties to the Multilateral MOU.

10 See letter from Mr. Wenman to Mr. Hardman dated September 29, 1998.

11 See letters from Mark Ibbotson, Director, Market Services, LIFFE, to Sharon Lawson, Senior Special Counsel, SEC, dated August 31, 1999 and from Laurence Walton, Senior Associate, Market Secretariat, LIFFE, to Ms. Lawson dated October 1, 1999. Specifically, in the August 31 letter LIFFE represents that the effect of the ISD is to require by law information sharing within and between relevant organizations in the European Economic Area member states. This sharing of information encompasses the basic information that would be included in a comprehensive information-sharing agreement. Through the ISD, LIFFE represents that the FSA would be able to obtain and share such information. Further, gateways in the ISD and United Kingdom law enable the FSA to pass the information to LIFFE.

12 On September 25, 1991, a Memorandum of Understanding ("MOU") was entered into by the U.K. Department of Trade and Industry and Securities Investment Board ("SIB") and the U.S. CFTC and SEC with respect to the sharing of confidential information among agencies and mutual assistance in investigation and enforcement matters. Also, the CFTC has granted Regulation 30.10 relief to SIB, the FSA's predecessor. See Appendix C to Commission Regulation 30.10, 17 C.F.R. § 30.10. FSA also is a signatory to the Declaration on Cooperation and Supervision of International Futures Exchanges and Clearing Organizations, as amended, signed on March 15, 1996 at Boca Raton, Florida.

13 The staff of the SEC has informed us that they would have no objection to the offer and sale of the FTSE Eurotop 100 futures contract traded on LIFFE in the U.S. See letter from Belinda Blaine, Associate Director, Division of Market Regulation, SEC, to David R. Merrill, Deputy General Counsel, CFTC, dated March 3, 2000.

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