

CFTC Letter No. 00-55

April 5, 2000

No-Action

Office of General Counsel

Ms. Karen Dixon
Marketing Director
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 Eurobloc 100 Index, the FTSE International Limited Eurotop 300 Index, and the FTSE International Limited Eurotop 300 (Ex. U. K.) Index, Traded on The London International Financial Futures and Options Exchange

Dear Ms. Dixon:

This is in response to letters and facsimiles dated from May 18, 1999 through March 10, 2000, 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 The London International Financial Futures and Options Exchange's ("LIFFE") futures contracts based on the FTSE International Limited Eurobloc 100 Index ("FTSE Eurobloc 100 Index"), the FTSE International Limited Eurotop 300 Index ("FTSE Eurotop 300 Index"), and the FTSE International Limited Eurotop 300 (Ex. U.K.) Index ("FTSE Eurotop 300 (Ex. U.K.) Index") (collectively, "Indices").

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.¹

The FTSE Eurobloc 100 Index, the FTSE Eurotop 300 Index and the FTSE Eurotop 300 (Ex. U.K.)

Index are all broad-based, modified capitalization-weighted composite indices designed and administered by FTSE International Limited.² The FTSE Eurobloc 100 Index is designed to represent the stock of the 60 largest publicly-held companies in the FTSE Eurotop 300 Eurobloc Index,³ and 40 additional stocks to ensure that the FTSE Eurobloc 100 Index consists of a representative cross-section of industries. Stock issuers represented in the FTSE Eurobloc 100 Index must be incorporated in the 11 members of the European Union that have entered into the European Monetary Union. The FTSE Eurotop 300 Index is designed to track the performance of the 300 largest stock issuers in the "European Region."⁴ The FTSE Eurotop 300 (Ex. U.K.) Index includes the stocks in the FTSE Eurotop 300 Index excluding companies that are incorporated in the U.K.

Based on data supplied by LIFFE, the total market capitalizations of the FTSE Eurobloc 100 Index, the FTSE Eurotop 300 Index and the FTSE Eurotop 300 (Ex. U.K.) Index were about U.S. \$3.3 trillion, \$6.9 trillion and \$4.7 trillion, respectively, as of December 31, 1999.⁵ Stock selection criteria ensure that only the most liquid stocks are included in the Indices. As of December 31, 1999, no single stock in the FTSE Eurobloc 100 Index, the FTSE Eurotop 300 Index and the FTSE Eurotop 300 (Ex. U.K.) Index represented more than 6.61%, 3.14% and 4.70%, respectively, of the market capitalizations of the Indices. The five most heavily-weighted stocks in each of the Indices represented only 20.25% of the market capitalization of the FTSE Eurobloc 100 Index, 12.74% of the FTSE Eurotop 300 Index and 15.24% of the FTSE Eurotop 300 (Ex. U.K.) Index. The FTSE Eurobloc 100 Index is reviewed annually by FTSE International Limited for index adjustments. Index adjustment reviews of the FTSE Eurotop 300 Index and the FTSE Eurotop 300 (Ex. U.K.) Index occur quarterly. FTSE International Limited calculates the Indices in real time and disseminates the Indices through electronic media, such as Reuters and Bloomberg, every 15 seconds.

Futures contracts based on the Indices have traded on the LIFFE since May 25, 1999. The terms and conditions for each subject contract are identical, with the exception of the underlying index. All of these contracts provide for cash settlement. The notional value for each of the contracts is determined by multiplying the relevant Index by 20 euros. Prices are quoted in Index points with each Index point equal to 20 euros per contract. Contract delivery months are the three nearest months in the March quarterly cycle, 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) on the last trading day.⁶

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.⁷ 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 Indices are issued by European companies only. With respect to futures contracts based on such foreign securities indices, 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." S. Rep. No. 390, 97th Cong., 2d Sess. 6 (1982). See H.R. Rep. No. 565, Part 1, 97th Cong., 2d Sess. at 39. Accordingly, we have examined LIFFE's FTSE Eurobloc 100 Index, FTSE Eurotop 300 Index, and FTSE Eurotop 300 (Ex. U.K.) Index futures contracts 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 these futures contracts conform 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 which are the home securities exchanges for the stocks underlying the index. The FTSE Eurobloc 100 Index currently contains stocks that are traded on securities exchanges in eight European countries.⁸ The FTSE Eurotop 300 Index includes stocks traded on exchanges in sixteen European countries,⁹ and the FTSE Eurotop 300 (Ex. U.K.) Index includes stocks traded on these same exchanges except those traded in the U.K. LIFFE has exchange-to-exchange surveillance-sharing agreements with the securities exchanges in two countries, the U.K. and the Netherlands. The Netherlands is represented

in the FTSE Eurobloc 100 Index and the FTSE Eurotop 300 (Ex. U.K.) Index, and both the U.K. and the Netherlands are represented in the FTSE Eurotop 300 Index. 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 300 Index futures contract and component stocks of that Index traded on the LSE. Moreover, in the Netherlands, LIFFE has entered into an information-sharing agreement with the Amsterdam Exchanges for the exchange of information regarding stocks on all the Indices.¹⁰ The component stocks covered by these exchange-to-exchange surveillance-sharing agreements represent 41.47% of the market capitalization of the FTSE Eurotop 300 Index, 16.07% of the FTSE Eurobloc 100 Index, and 12.29% of the FTSE Eurotop 300 (Ex. U.K.) 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 member countries. In the U.K., the FSA is the main competent authority for the ISD's purposes. All of the countries that have stock represented in the FTSE Eurobloc 100 Index are subject to the ISD. With respect to the FTSE Eurotop 300 Index and the FTSE Eurotop 300 (Ex. U.K.) Index, all of the countries represented are subject to the ISD except Switzerland.¹¹ Stocks traded on the securities exchanges in these countries represent 91.84% and 87.77% of the value of the FTSE Eurotop 300 Index and the FTSE Eurotop 300 (Ex. U.K.) Index, respectively.¹² 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.¹³ Moreover, LIFFE has represented that through the ISD it can receive information about market trading, clearing activity, and customer identity.¹⁴

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 Indices. 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 Indices. 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.¹⁵

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 Eurobloc 100 Index, FTSE Eurotop 300 Index, and FTSE Eurotop 300 (Ex. U.K.) Index futures contracts traded on LIFFE are offered and sold in the U.S.¹⁶ 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 Eurobloc 100 Index, FTSE Eurotop 300 Index, and FTSE Eurotop 300 (Ex. U.K.) Index futures contracts is, of course, subject to the Part 30 regulations adopted by the Commission to govern the offer and sale of foreign futures and foreign options contracts in the U.S. ¹⁷

Yours truly,

David R. Merrill
Deputy General Counsel

cc: Ms. Annette L. Nazareth, Director
Division of Market Regulation
Securities and Exchange Commission

Michael M. Philipp, Esq.
Katten, Muchin and Zavis

1 In addition, the United Kingdom's Department of Trade and Industry and the Serious Fraud Office also play a role in preventing market manipulation and fraud. The Commission staff recently discussed 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. 99-31, [1998-1999 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 27,744 (July 23, 1999).

2 The Office of the General Counsel recently issued no-action relief for another LIFFE futures contract based on a FTSE International Limited-designed index, the FTSE Eurotop 100. See CFTC Staff Letter No. 00-27 (March 10, 2000).

3 The FTSE Eurotop 300 Eurobloc Index is a sub-index of the FTSE Eurotop 300 Index. The FTSE Eurotop 300 Eurobloc Index consists of the stocks in the FTSE Eurotop 300 Index from countries that have entered the European Monetary Union.

4 FTSE International Limited defines the "European region" as 17 countries in western and central Europe, including Germany, France, the U.K., Italy, Spain, Portugal, Belgium, the Netherlands, Luxembourg, Denmark, Sweden, Finland, Austria, Ireland, Greece, Switzerland and Norway.

5 See letter from Karen Dixon, Market Director, LIFFE, to David R. Merrill, Deputy General Counsel, CFTC, dated March 10, 2000.

6 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.

7 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).

8 Austria, Luxembourg and Portugal are not represented in the FTSE Eurobloc 100 Index as of December 31, 1999, although stocks traded in these countries are eligible for inclusion in the index.

9 Luxembourg is not represented in the FTSE Eurotop 300 Index or the FTSE Eurotop 300 (Ex. U.K.) Index as of December 31, 1999, although stocks traded in Luxembourg are eligible for inclusion in the index.

10 See letter from Ms. Dixon to Mr. Merrill, dated February 11, 2000.

11 The U.K. has entered into a bilateral memorandum of understanding with Switzerland. Although Norway, like Switzerland, is not a member of the European Union, it is a member of the European Economic Area and LIFFE represents that by virtue of this membership, Norway has adopted the ISD. See letter from David Wenman, Managing Director (Development), LIFFE, to Harold Hardman, Assistant General Counsel, CFTC, dated May 18, 1999.

12 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 Indices, except Switzerland, are parties to the Multilateral MOU.

13 See letter from Mr. Wenman to Mr. Hardman, dated May 18, 1999.

14 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 to LIFFE information received pursuant to the ISD.

15 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.

16 The staff of the SEC has informed us that they would have no objection to the offer and sale of the FTSE Eurobloc 100 Index, the FTSE Eurotop 300 Index and the FTSE Eurotop 300 (Ex. U.K.) Index futures contracts traded on LIFFE to U.S. persons. See letter from Belinda Blaine, Associate Director, Division of Market Regulation, SEC, to C. Robert Paul, General Counsel, CFTC, dated March 29, 2000.

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