

CFTC Letter No. 01-47
May 30, 2001
No-Action
Office of General Counsel

N. P. Weinreb
Director, Market Secretariat
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 United States of the mini
Futures Contract Based on the FTSE 100 Index Traded on The London International
Financial Futures and Options Exchange

Dear Mr. Weinreb:

This is in response to your letters, attachments, and facsimiles, dated from November 7, 2000 to March 29, 2001, requesting that the Office of 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 mini futures contract based on the FTSE 100 Index ("FTSE 100" or "Index") traded on The London International Financial Futures and Options Exchange ("LIFFE"). This Office has previously issued a no-action letter to LIFFE for its futures contract based on the FTSE 100.^[1]

We understand the facts to be as follows. LIFFE is a recognized investment exchange that is subject to regulatory oversight by the Financial Services Authority ("FSA"). The FSA has comprehensive authority for regulating the financial services industry in the United Kingdom ("U.K.").^[2]

The FTSE 100 is a broad-based, modified capitalization-weighted index composed of 100 highly capitalized stocks of companies incorporated in the U.K. that have a primary listing in the U.K. and are traded significantly on an exchange located in the U.K. The Index represents approximately 80% of the market capitalization of the entire U.K. equity market, as measured by the total market capitalization of stocks within the FTSE All Share Index.^[3] Based on data supplied by LIFFE, the total market capitalization of the FTSE 100 was approximately £1,444 billion, or about U.S. \$2.090 trillion, as of February 19, 2001. The FTSE 100 is maintained by FTSE International Limited, an independent stock index provider. As of November 1, 2000, no single stock in the Index represented more than 11.92% of

the Index, and the five most heavily-weighted stocks in the Index represented 35.75% of the Index.^[4] The stocks comprising the lowest 25% of the Index had a six-month average daily trading volume of approximately £145 billion, or U.S. \$203 billion, for the period through September 29, 2000. The Index is calculated in real time and is disseminated through electronic means at fifteen-second intervals.

LIFFE's mini futures contract on the FTSE 100 is identical to LIFFE's existing futures contract on the FTSE 100, except that the mini futures contract is one-fifth the size of the current contract. The mini futures contract provides for cash settlement. The notional value for the mini futures contract is determined by multiplying the Index by £2. Contract delivery months are the three nearest months in the March quarterly cycle. The last trading day for the contract is the third Friday of the delivery month. Contracts are cash settled on the first business day after the last trading day based on the final settlement price of the FTSE 100 on the last trading day. The final settlement price for the mini futures contract is an average of Index values observed at fifteen second intervals between 10:10 A.M. and 10:30 A.M. (London time) inclusive on the last trading day.^[5]

The Commodity Exchange Act ("CEA"),^[6] as amended by the Commodity Futures Modernization Act of 2000 ("CFMA"),^[7] provides that the offer or sale in the United States of futures contracts based on a group or index of securities, including those contracts traded on or subject to the rules of a foreign board of trade, is subject to the Commission's exclusive jurisdiction,^[8] with the exception of security futures products,^[9] over which the Commission shares jurisdiction with the Securities and Exchange Commission ("SEC").^[10] Thus, the Commission's jurisdiction remains exclusive with regard to futures contracts on a group or index of securities that are broad-based pursuant to CEA Section 1a(25).^[11]

CEA Section 2(a)(1)(C)(iv) generally prohibits any person from offering or selling a futures contract based on a securities index in the United States, except as permitted under CEA Section 2(a)(1)(C)(ii) or CEA Section 2(a)(1)(D).^[12] By its terms, CEA Section 2(a)(1)(C)(iv) applies to futures contracts on securities indices traded on both domestic and foreign boards of trade. CEA Section 2(a)(1)(C)(ii) sets forth three criteria to govern Commission designation of boards of trade as contract markets and registration of derivatives transaction execution facilities ("DTF") to trade 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 group or index of securities must not constitute a narrow-based securities index.^[13]

While Section 2(a)(1)(C)(ii) provides that no board of trade shall be designated as a contract market (or

registered as a DTF) with respect to stock index futures contracts unless it meets the three criteria noted above, it does not explicitly address the standards to be applied to foreign stock index futures contracts traded on foreign boards of trade. This Office has decided to apply those same three criteria in evaluating requests by foreign boards of trade to allow the offer and sale within the United States of their foreign stock index futures contracts when those foreign boards of trade do not seek designation as a contract market or registration as a DTF to trade those products.

Accordingly, this Office has examined the FTSE 100 and the mini futures contract based thereon to determine whether the Index and the mini futures contract meet the requirements enumerated in CEA Section 2(a)(1)(C)(ii). Based on the information noted herein and as set forth in the letters, attachments, and facsimiles noted above, we have determined that the FTSE 100 and the mini futures contract based thereon conform to these requirements.^[14]

In determining whether a foreign futures contract based on a foreign stock index is not readily susceptible to manipulation or being used to manipulate any underlying security, one preliminary consideration is the requesting exchange's ability to access information regarding the stocks underlying the index. All of the stocks that comprise the FTSE 100 Index are traded on the London Stock Exchange ("LSE"). LIFFE has signed a regulatory agreement with LSE that provides for the exchange of information regarding the component stocks of the FTSE 100 Index traded on the LSE.^[15] Thus, LIFFE should have access to information necessary to detect or deter manipulation. In the event that LIFFE is unable to obtain access to adequate surveillance data in this regard, or is unable to share such data with the CFTC, this Office reserves the right to reconsider the position we have taken herein.^[16]

In light of the foregoing, the Office of General Counsel will not recommend any enforcement action to the Commission based on Sections 2(a)(1)(C)(iv), 4(a), or 12(e) of the CEA, as amended, if the mini futures contract based on the FTSE 100 and traded on LIFFE is offered or sold in the U.S. 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. In addition, this position may be affected by any rules that the Commission or SEC may adopt regarding futures contracts based on securities indices.

The offer and sale in the U.S. of LIFFE's mini futures contract on the FTSE 100 is, of course, subject to Part 30 of the Commission's regulations which govern the offer and sale of foreign futures and foreign option contracts in the U.S.^[17]

Sincerely,

David R. Merrill
Deputy General Counsel

[1] See CFTC Letter No. 90-1, [1987-1990 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 24,582 (January 16, 1990).

[2] In addition, the United Kingdom's Department of Trade and Industry and the Serious Fraud Office play a role to prevent market manipulation and fraud. See CFTC Staff Letter No. 99-34, [1998-1999 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 27,744 (July 23, 1999).

[3] See letter from N.P. Weinreb, Director, Market Secretariat, LIFFE, to David R. Merrill, Deputy General Counsel, CFTC, dated March 29, 2001.

[4] See letter from N.P. Weinreb, Director, Market Secretariat, LIFFE, to Harold L. Hardman, Assistant General Counsel, CFTC, dated November 7, 2000.

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

[6] 7 U.S.C. § 1 *et seq.*

[7] Appendix E of Pub. L. 106-554, 114 Stat. 2763 (2000).

[8] See CEA Section 2(a)(1)(C)(ii)./

[9] Security futures products are defined as a security future or any put, call, straddle, option, or privilege on any security future. See CEA Section 1a(32). A security future is defined as a contract of sale for future delivery of a single security or of a narrow-based security index, including any interest therein or based on the value thereof, with certain exceptions. See CEA Section 1a(31).

[10] See CEA Section 2(a)(1)(D)./

[11] See CEA Section 2(a)(1)(C)(ii).

[12] Section 2(a)(1)(D) governs the offer and sale of security futures products.

[13] The first two criteria under CEA Section 2(a)(1)(C)(ii) were unchanged by the CFMA. With regard to the third criterion, an index is a "narrow-based security index" under both the CEA and the Securities

Exchange Act ("SEA"), 15 U.S.C. § 78a *et seq.*, if it has any one of the following four characteristics: (1) it has nine or fewer component securities; (2) any one of its component securities comprises more than 30% of its weighting; (3) the five highest weighted component securities in the aggregate comprise more than 60% of the index's 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 of less than \$50 million (or in the case of an index with 15 or more component securities, \$30 million). *See* CEA Section 1a(25)(A)(i)-(iv); SEA Section 3(a)(55)(B)(i)-(iv). Thus, an index that does not have any of these elements is not a narrow-based security index for purposes of CEA Section 2(a)(1)(C)(ii). *See also* CEA Section 1a(25)(B); SEA Section 3(a)(55)(C).

[14] In making this determination, the staff has concluded that the FTSE 100 does not have any of the elements of a narrow-based security index as enumerated in CEA Section 1a(25)(A).

[15] *See* letter from Mr. Weinreb to Mr. Hardman, dated November 7, 2000.

[16] LIFFE confirms that it is willing and able to provide market and other surveillance information to the Commission on an "as needed basis," via the exchange's regulator, the FSA, regarding the mini futures contract on the FTSE 100. *See* letter from Mr. Weinreb to Mr. Merrill, dated March 29, 2001. Moreover, both LIFFE and LSE are affiliate members of the Intermarket Surveillance Group ("ISG"), which is comprised of representatives from U.S. and non-US securities and futures exchanges with observers from the SEC and CFTC. The members of ISG have agreed to share information to ensure coordinated surveillance of intermarket trading abuses. LIFFE also is a signatory to the International Information Sharing Memorandum of Understanding signed on March 15, 1996 at Boca Raton, Florida.

On September 25, 1991, a Memorandum of Understanding ("MOU") was entered into by the U.K. Department of Trade and Industry and the 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. LIFFE represents that the mini futures contract on the FTSE 100 Index, like the FTSE 100 futures contract, falls squarely within the terms of the MOU. In addition, 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.

[17] *See* 17 C.F.R. Part 30.