

CFTC Letter No. 02-38

April 2, 2002

No-Action

Division of Trading and Markets

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Re: Eurex Deutschland's Request for No-Action Relief in Connection with the Offer and Sale of its futures contracts based on the Dow Jones STOXX 600 Banking Sector Index and the Dow Jones EURO STOXX Banking Sector Index in the United States

Dear Mr. Rosen:

This is in response to your letters, attachments, facsimiles and electronic mail dated from November 2, 2001 to February 8, 2002, requesting that the Office of General Counsel ("Office") 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 futures contracts based on the Dow Jones STOXX 600 Banking Sector Index ("STOXX 600 Banking Sector Index") and the Dow Jones EURO STOXX Banking Sector Index ("EURO STOXX Banking Sector Index") (collectively, "Indices") traded on Eurex Deutschland ("Eurex").

We understand the facts to be as follows. Eurex is a futures and options exchange located in Frankfurt, Germany and operated by Eurex Frankfurt AG. Eurex is regulated by and subject to active market surveillance by self-regulatory agencies, the Exchange Supervisory Authority in the State of Hesse, where Eurex is located, and by the German Federal Supervisory Office for Securities Trading (the "BAWe"). Pursuant to the German Securities Trading Act, the BAWe has responsibility for the supervision of German securities and derivatives trading, and has the authority to cooperate with competent authorities of other countries in connection with the supervision of securities and derivatives markets and trading activity thereon, including by sharing non-public market surveillance information.

The STOXX 600 Banking Sector Index and the EURO STOXX Banking Sector Index are both broad-based, "free-float" capitalization-weighted Indices designed and administered by STOXX Limited, a joint venture of Deutsch Börse AG, Dow Jones & Company, Euronext Paris SA and Swiss Exchange SWX.^[1] The STOXX 600 Banking Sector Index is a subset of the Dow Jones STOXX 600 Index, which is composed of the 600 largest stocks in the Dow Jones STOXX Total Market Index. The latter is designed to measure 95 percent of the "free-float" market capitalization of the investable universe of publicly-traded stocks in Europe. The STOXX 600

Banking Sector Index is comprised of the stocks of companies engaged primarily in the business of banking contained in the Dow Jones STOXX 600 Index.^[2] The EURO STOXX Banking Sector Index consists only of those banking sector stocks contained in the STOXX 600 Banking Sector Index that are from issuers organized in countries participating in the European Monetary Union.^[3]

Based on data supplied by Eurex, the total market capitalizations of the STOXX 600 Banking Sector Index and the EURO STOXX Banking Sector Index were U.S. \$786.5 billion and U.S. \$337.3 billion, respectively, as of October 10, 2001. As of that date, no single stock in the STOXX 600 Banking Sector Index and the EURO STOXX Banking Sector Index represented more than 12.9% and 10.7% of the Indices, respectively. The five most heavily weighted stocks in the Indices represented 41.5% of the STOXX 600 Banking Sector Index and 48.3% of the EURO STOXX Banking Sector Index. The stocks comprising the lowest 25% of both the STOXX 600 Banking Sector Index and the EURO STOXX Banking Sector Index had a six-month aggregate dollar value of average daily trading volume in excess of U.S. \$30 million: U.S. \$767.0 million and U.S. \$302.7 million, respectively, for the period from April to September 2001.^[4] The Indices are calculated in real time and are disseminated by electronic means through major data vendors in 15-second intervals.

With the exception of the index underlying each contract, the terms and conditions for Eurex's futures contracts on the STOXX 600 Banking Sector Index and EURO STOXX Banking Sector Index are identical. Both futures contracts provide for cash settlement. The notional value for both futures contracts is determined by multiplying the relevant index by 50 Euros. Both futures contracts list the three nearest months of the March quarterly cycle, and the last trading day for both futures contracts is the third Friday of the delivery month. Cash settlement occurs on the first business day after the last trading day. The final settlement price for each contract is calculated on the last day of trading and is the arithmetic mean of the relevant STOXX 600 Banking Sector Index or EURO STOXX Banking Sector Index levels, calculated between 11:50 A.M. and 12 noon Central European Time (41 values).^[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 (“DTFs”) to trade futures contracts on a group or index of securities:

1. (1) the contract must provide for cash settlement;
2. (2) the contract must not be readily susceptible to manipulation nor to being used to manipulate any underlying security; and
3. (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 determined 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 STOXX 600 Banking Sector Index and the EURO STOXX Banking Sector Index and the futures contracts based thereon to determine whether the Indices and the futures contracts 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, facsimiles and electronic mail noted above, we have determined that both the STOXX 600 Banking Sector Index and the EURO STOXX Banking Sector Index, and Eurex’s futures contracts 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. Eurex’s regulator, the BAWe, is a signatory to the Multilateral Memorandum of Understanding on the Exchange of Information and Surveillance of Securities Activities, signed by the members of the Forum of European Securities Commissions (“FESCO MOU”). All of the regulators of the exchanges where the component stocks underlying the Indices are traded, with the exception of Switzerland, are signatories to the FESCO MOU.^[15] Eurex represents that the FESCO MOU provides for sharing of certain market surveillance data among FESCO Members, including the identity of the ultimate customer to a transaction.^[16] In addition, Eurex’s Trading Surveillance Office is authorized under the German Exchange

Act to obtain information directly from, and share information directly with, similar trading surveillance offices of other exchanges or regulators outside of Germany. Eurex may also request that BAWe obtain information from other regulators.

In consideration of the various bilateral and multilateral information-sharing arrangements to which the BAWe is a party, as noted herein, and Eurex's representation concerning its own capacity to obtain and share information, this Office has concluded that Eurex should have access to the information necessary to detect and deter manipulation. In the event that Eurex 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.^[17]

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 Eurex's futures contracts based on the STOXX 600 Banking Sector Index and the EURO STOXX Banking Sector Index are offered or sold in the U.S. Because this position is based upon facts and representations contained in the letters, attachments, facsimiles and electronic mail 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 Eurex with all regulatory requirements imposed by the BAWe, and the applicable laws and regulations of Germany and the State of Hesse. In addition, this position may be affected by any rules that the Commission may adopt regarding futures contracts based on non-narrow-based securities indices.

The offer and sale in the U.S. of Eurex's futures contracts on the STOXX 600 Banking Sector Index and the EURO STOXX Banking Sector Index 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.^[18]

Sincerely,

Patrick J. McCarty
General Counsel

^[1] See letter from Edward J. Rosen, Esq., Cleary, Gottlieb, Steen & Hamilton to David R. Merrill, Acting General Counsel, CFTC, dated November 2, 2001.

^[2] *Id.* As of October 10, 2001, the STOXX 600 Banking Sector Index consisted of

62 stocks from issuers in fifteen European countries, including Italy, the United Kingdom, Greece, Spain, Germany, Sweden, Belgium, France, Ireland, Norway, Portugal, Switzerland, Austria, Denmark and the Netherlands.

[3] *Id.* As of October 10, 2001, the EURO STOXX Banking Sector Index consisted of 44 stocks from issuers in ten European countries, including Italy, Greece, Spain, Germany, Belgium, France, Ireland, Portugal, Austria and the Netherlands.

[4] See letter from Edward J. Rosen, Esq., Cleary, Gottlieb, Steen & Hamilton to David R. Merrill, Acting General Counsel, CFTC, dated February 8, 2002.

[5] See letter from Mr. Rosen to Mr. Merrill, dated November 2, 2001.

[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] CEA 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 (“Exchange Act”), 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); Exchange Act 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); Exchange Act Section 3(a)(55)(C).

[14] In making this determination, the staff has concluded that neither the STOXX 600 Banking Sector Index nor the EURO STOXX Banking Sector Index have any of the elements of a narrow-based security index as enumerated in CEA Section 1a(25)(A).

[15] The BAWe has signed a bilateral Memorandum of Understanding with Switzerland. The BAWe also has signed bilateral information-sharing agreements with regulators in, among other countries, the Czech Republic, France, Hungary, Italy, Poland, Portugal, Spain and Turkey. See letter from Mr. Rosen to Mr. Merrill, dated November 2, 2001.

[16] *Id.*

[17] Eurex confirms that it is willing and able to cooperate through information sharing and other means with the Commission in relation to the trading of Eurex's futures contracts on the STOXX 600 Banking Sector Index and EURO STOXX Banking Sector Index. See letter from Mr. Rosen to Mr. Merrill, dated November 2, 2001. In addition, Eurex is a signatory to the International Information Sharing Memorandum of Understanding and Agreement signed on March 15, 1996, at Boca Raton, Florida.

The BAWe and the CFTC entered into a Memorandum of Understanding concerning Consultation and Cooperation in the Administration and Enforcement of Futures Laws on October 17, 1997 ("MOU"). The BAWe has confirmed that it will continue to cooperate with the Commission pursuant to the MOU with respect to Eurex's futures contracts on the Indices. See letter from Georg Wittich, President, BAWe to John C. Lawton, Acting Director, Division of Trading and Markets, CFTC, dated March 6, 2002. Moreover, the BAWe is a signatory to the Declaration on Cooperation and Supervision of International Futures Exchanges and Clearing Organizations for the sharing of large exposure information, as amended, March 20, 1998 ("Boca Declaration").

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