

CFTC Letter No. 02-80
June 28, 2002
No Action
Office of General Counsel

Re: JSE Securities Exchange South Africa's Request for No-Action Relief in Connection with the Offer and Sale of its Futures Contract on the FTSE/JSE 40 Top Companies Index in the United States

Dear Mr. Raisler:

This is in response to letters, attachments, facsimiles and electronic mail dated from March 14, 2002 to June 14, 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 a futures contract based on the FTSE/JSE 40 Top Companies Index ("FTSE/JSE Top 40" or "Index") traded on JSE Securities Exchange South Africa ("JSE").

We understand the facts to be as follows. JSE is a licensed, privately-owned securities and derivatives exchange located in South Africa and subject to regulation by the South African Financial Services Board ("FSB").^[1] The FSB is the regulatory authority tasked with ensuring that the JSE operates its stock and derivatives markets in the public interest and in accordance with the legislation governing the operation of stock and derivatives exchanges in South Africa. Among its powers, the FSB may disclose to any foreign financial services regulatory authority information relating to a particular financial institution or a particular individual, whether or not specified, who is or was involved in a particular financial institution or financial service if the executive officer of the FSB is of the opinion that, taking into consideration the public interest, such information will be of importance to the relevant foreign financial services regulatory authority.

The FTSE/JSE Top 40 is a broad-based, modified "free float" capitalization-weighted composite index, co-owned and co-managed by FTSE International Ltd. and JSE. The FTSE/JSE Top 40 is designed to reflect the overall performance of the stocks of the largest companies traded on JSE and is composed of the stocks of 40 of the largest companies, in terms of full market value, traded on JSE. Based on data supplied by JSE, the total market capitalization of the FTSE/JSE Top 40 was approximately U.S. \$117.5 billion as of December 31, 2001.^[2] As of that date, no single stock in the FTSE/JSE Top 40 represented more than 21.72% of the Index. The five most heavily-weighted stocks in the FTSE/JSE Top 40 represented 53.34% of the Index. The stocks comprising the lowest 25% of the FTSE/JSE Top 40 had a six-month aggregate dollar value of average daily trading volume of approximately U.S. \$90 million for the period from July 1, 2001 to December 31, 2001.^[3] The Index is calculated in real time and is disseminated by electronic means through major data vendors in 15-second intervals.

JSE's futures contract on the FTSE/JSE Top 40 provides for cash settlement. The notional value for the

futures contract is determined by multiplying the Index by 10 Rand. JSE lists for trading the four nearest months of the March quarterly cycle, and the last trading day for the contract is the third Thursday of the delivery month. Cash settlement occurs on the first business day after the last trading day. The final settlement price for the contract is calculated on the last day of trading and is the arithmetic mean of the Index levels calculated every minute, on the minute, for 100 iterations between 2:01 P.M. and 3:40 P.M. South Africa time.^[4]

The Commodity Exchange Act (“CEA”),^[5] as amended by the Commodity Futures Modernization Act of 2000 (“CFMA”),^[6] 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,^[7] with the exception of security futures products,^[8] over which the Commission shares jurisdiction with the Securities and Exchange Commission (“SEC”).^[9] 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).^[10]

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).^[11] 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 contract markets and derivatives transaction execution facilities (“DTFs”) trading 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 group or index of securities must not constitute a narrow-based securities index.^[12]

While Section 2(a)(1)(C)(ii) provides that no board of trade or DTF may trade a stock index futures contracts unless it meets the three criteria noted above, it does not explicitly address the standards to be applied to a foreign stock index futures contract traded on a foreign board of trade. This Office has applied 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.^[13]

Accordingly, this Office has examined the FTSE/JSE Top 40 and the futures contract based thereon to determine whether the Index and the 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,

facsimiles and electronic mail noted above, we have determined that the FTSE/JSE Top 40, and JSE's futures contract based thereon, conform to these requirements.^[14]

In determining whether a foreign futures contract based on a foreign security 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. As noted above, all the stocks underlying the FTSE/JSE Top 40 are traded on the JSE. Some of the component stocks have their primary listing on the London Stock Exchange, with which the JSE has an information sharing agreement.^[15] Thus, the JSE should have access to information necessary to detect and deter manipulation. In the event that JSE 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 JSE's futures contract based on the FTSE/JSE Top 40 is 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 JSE with all regulatory requirements imposed by the FSB, and the applicable laws and regulations of South Africa. 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 JSE's futures contracts on the FTSE/JSE Top 40 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,

Patrick J. McCarty
General Counsel

^[1] In August 2001, JSE acquired the business of The South African Futures Exchange ("SAFEX"), which is now incorporated into the JSE's business as a Financial Derivatives Division and an Agricultural Products Division. SAFEX's old business is now operated by the JSE on substantially the same basis as it was within SAFEX. The rules of SAFEX were adopted by the JSE in materially the same format, and the members of SAFEX are now derivatives members of the JSE. *See* letter from Elbi J. van Vuuren, Legal Counsel, JSE, to General Counsel, CFTC, dated March 14, 2002.

[2] *Id.*

[3] *Id.*

[4] *Id.*

[5] 7 U.S.C. § 1 *et seq.*

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

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

[8] 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).

[9] *See* CEA Section 2(a)(1)(D).

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

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

[12] 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 of 1934 (“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).

[13] With regard to the third criterion, the CFTC and SEC jointly promulgated Rule 41.13 under the CEA and Rule 3a55-3 under the Exchange Act, governing security index futures contracts traded on foreign boards of trade. These rules provide that “[w]hen a contract of sale for future delivery on a security index is traded on or subject to the rules of a foreign board of trade, such index shall not be a narrow-based security index if it would not be a narrow-based security index if a futures contract on such index were traded on a designated contract market or registered derivatives transaction execution facility.”

CFTC Rule 41.13, 17 C.F.R. § 41.13; Exchange Act Rule 3a55-3, 17 C.F.R. § 240.3a55-3.

[14] In making this determination, the staff has concluded that the FTSE/JSE Top 40 does not have any of the elements of a narrow-based security index as enumerated in CEA Section 1a(25)(A), and accordingly would not be a narrow-based security index if traded on a designated contract market or registered derivatives transaction execution facility.

[15] See letter from Elbi J. van Vuuren, Legal Counsel, JSE, to David R. Merrill, Deputy General Counsel, CFTC, dated May 17, 2002.

[16] JSE confirms that it is willing and able to share information with the CFTC with regard to its futures contract on the FTSE/JSE Top 40. See letter from Mr. van Vuuren to Mr. Merrill, dated May 17, 2002. In addition, as successor in interest to SAFEX, JSE is bound by the International Information Sharing Memorandum of Understanding and Agreement signed on March 15, 1996, at Boca Raton, Florida.

The CFTC and the FSB signed a Joint Communiqué on Exchange of Information for Cooperation and Consultation on May 27, 1997 (“Joint Communiqué”). The FSB has confirmed that it is willing and able to share any relevant information, including market and surveillance data information with respect to the ultimate customer to a transaction, concerning JSE’s futures contract on the FTSE/JSE Top 40 and the securities underlying the Index, pursuant to the Joint Communiqué. See letter from N. Muller, Senior Manager, Department of Financial Markets, FSB, to David R. Merrill, Deputy General Counsel, CFTC, dated May 7, 2002. In addition, the FSB is a signatory to the Declaration on Cooperation and Supervision of International Futures Markets and Clearing Organizations, dated March 15, 1996.

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