

CFTC Letter No. 02-81
June 28, 2002
No Action
Office of General Counsel

Re: Eurex Deutschland's Request for No-Action Relief in Connection with the Offer and Sale of its Futures Contract on the Dow Jones Global Titans 50 Index in the United States

Dear Mr. Rosen:

This is in response to your letters, attachments, facsimiles and electronic mail dated from November 20, 2001 to June 10, 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 Dow Jones Global Titans 50 Index ("Global Titans 50" or "Index") 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 Global Titans 50 is a broad-based, modified "free float" capitalization-weighted index designed and administered by Dow Jones Indexes, a part of Dow Jones & Company, Inc.^[1] The Global Titans 50 consists of the 50 largest stocks in the Dow Jones World Index.^[2] Based on data supplied by Eurex, the total market capitalization of the Global Titans 50 was approximately U.S. \$5.6 trillion as of October 16, 2001. As of that date, no single stock in the Global Titans 50 represented more than 6.77% of the Index. The five most heavily weighted stocks in the Global Titans 50 represented 25.52% of the Index. The stocks comprising the lowest 25% of the Global Titans 50 had a six-month aggregate dollar value of average daily trading volume of U.S. \$6.2 billion for the period from April to September 2001.^[3] The Index is calculated in real time and is disseminated by electronic means through major data vendors in 15-second intervals.

Eurex's futures contract on the Global Titans 50 provides for cash settlement. The notional value for the futures contract is determined by multiplying the relevant index by 100 Euros. Eurex lists for trading the three nearest months of the March quarterly cycle, and the last trading day for the contract 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 the contract is calculated on the last day of trading and is the arithmetic

mean of the Index levels, calculated between 4:50 P.M. and 5:00 P.M. Central European Time (41 values).^[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 Global Titans 50 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 Global Titans 50, and Eurex’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. With respect to the component stocks traded in Germany, Eurex's federal regulator, the BAWe, is responsible for supervision of trading in component stocks of the Global Titans 50 traded on the Frankfurt Stock Exchange ("FSE") and its Xetra system. With respect to component stocks traded outside of Germany, the BAWe generally has access to surveillance data from regulators who supervise trading in those stocks through various information-sharing memoranda of understanding and other arrangements. With regard to stocks traded on European exchanges, the members of the Forum of European Securities Commissions, which include the BAWe and regulators of all the European exchanges on which the component stocks are traded, other than Swiss regulators, are signatories to the Multilateral Memorandum of Understanding on the Exchange of Information and Surveillance of Securities Activities ("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] With regard to the component stocks traded on securities exchanges outside of Europe, the BAWe has developed an efficient cooperation for the exchange of information with the Japanese Financial Services Agency, and has entered into bilateral memoranda of understanding with both the SEC and the CFTC in the United States for the exchange of information.^[17]

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. The FSE's Trading Surveillance Office is similarly authorized to exchange surveillance information with Eurex. The FSE is an affiliate member of the Intermarket Surveillance Group ("ISG"), a group of primarily U.S. securities and futures exchanges that shares surveillance information.^[18] Eurex represents that the terms of FSE's affiliate membership in the ISG do not restrict the FSE from sharing with Eurex surveillance information received pursuant to such membership with respect to the component stocks of the Global Titans 50 that are traded on non-German ISG member exchanges. Eurex further represents that it will have sufficient access through the FSE and the FSE's affiliate membership in the ISG, as well as the other arrangements discussed above, to relevant surveillance information regarding the trading of the component stocks in the Global Titans 50.^[19]

In consideration of the various bilateral and multilateral information-sharing arrangements to which the BAWe is a party, as noted herein, Eurex's information-sharing arrangements, 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.^[20]

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 contract based on the Global Titans 50 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 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 Global Titans 50 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. ^[21]

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 20, 2001.

^[2] The Dow Jones World Index includes all eligible component stocks from all Dow Jones Global Indexes. The Dow Jones World Index is a broad market index that includes stocks from 34 countries, 10 economic sectors, 18 market sectors, 40 industry groups and 70 subgroups defined by the Dow Jones Global Industry Classification Structure. Dow Jones Company, Inc., screens all stocks from eligible markets by liquidity and share class to exclude stocks that are considered illiquid. Component securities must be common equity shares and may not be fixed-dividend shares, convertible notes, warrants, rights, mutual funds, unit investment trusts, closed-end fund shares, or shares in limited partnerships. In addition, any security that has no trading volume for more than ten days in the preceding quarter, on days when its primary market was open, is excluded from the Dow Jones World Index. See letter from Mr. Rosen to Mr. Merrill, dated November 20, 2001.

^[3] See letter from Edward J. Rosen, Esq., Cleary, Gottlieb, Steen & Hamilton to David R. Merrill, Acting General Counsel, CFTC, dated March 7, 2002.

^[4] See letter from Mr. Rosen to Mr. Merrill, dated November 20, 2001.

^[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 Global Titans 50 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] The BAWe has signed a bilateral Memorandum of Understanding with Switzerland. See letter from Mr. Rosen to Mr. Merrill, dated November 20, 2001.

[16] *Id.*

[17] 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 contract on the Index. *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.

[18] Specifically, the ISG was created under the auspices of the SEC in 1983 as a forum to ensure that U. S. national securities exchanges and national securities associations adequately share surveillance information and coordinate inquiries and investigations designed to address potential intermarket manipulations and trading abuses. All national securities exchanges and national securities associations are full members of the ISG. In view of the growth of stock index futures contracts, since 1987, several futures exchanges and non-U.S. exchanges and associations have become affiliate members of the ISG. It has been noted that this framework is an essential mechanism to ensure that there is adequate information sharing and investigatory coordination for potential intermarket manipulations and trading abuses. *See* 66 Fed. Reg. 37932, 37934 (July 20, 2001).

[19] *See* letter from Edward J. Rosen, Esq., Cleary, Gottlieb, Steen & Hamilton to David R. Merrill, Deputy General Counsel, CFTC, dated June 10, 2002.

[20] 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 Global Titans 50. *See* letter from Mr. Rosen to Mr. Merrill, dated November 20, 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.

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