

CFTC Letter No. 02-86
July 24, 2002
No Action
Office of General Counsel

Ms. Johanna Turner
Senior Lawyer
ASX Futures Exchange Pty Limited
ABN 18 006 599 364
Exchange Centre
Level 6, 20 Bridge Street
Sydney NSW 2000
Australia

Re: ASX Futures Exchange Pty Limited's Request for No-Action Relief in Connection with the Offer and Sale of its futures contracts based on the Standard & Poors/Australian Stock Exchange 200 Index and the Standard & Poors/Australian Stock Exchange 50 Index in the United States

Dear Ms. Turner:

This is in response to your letters, attachments, facsimiles and electronic mail dated from March 13, 2002 to June 12, 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 Standard & Poors ("S&P")/Australian Stock Exchange Limited ("ASX") 200 Index ("S&P/ASX 200") and the S&P/ASX 50 Index ("S&P/ASX 50") (collectively, "Indices") traded on ASX Futures Exchange Pty Limited ("ASXF").

We understand the facts to be as follows. ASXF is a self-regulating, licensed futures exchange located in Sydney, Australia and is a wholly-owned subsidiary of ASX, the Australian Stock Exchange. Both ASXF and ASX fall under the regulatory jurisdiction of the Australian Securities and Investments Commission ("ASIC"), which regulates both the futures and securities markets in Australia.

The S&P/ASX 200 and the S&P/ASX 50 are both broad-based, modified capitalization-weighted composite indices owned and managed by S&P, under license to ASXF.^[1] The S&P/ASX 200 is composed of 200 of the largest stocks listed for trading on the ASX. The S&P/ASX 50 consists of the top 50 stocks by market capitalization contained in the S&P/ASX 200. Based on data supplied by ASXF, the total market capitalizations of the S&P/ASX 200 Index and the S&P/ASX 50 Index were U. S. \$311.9 billion and U.S. \$262.9 billion, respectively, as of January 31, 2002.^[2] As of that date, no single stock in the S&P/ASX 200 Index and the S&P/ASX 50 Index represented more than 8.65% and 10.27% of the Indices, respectively.^[3] The five most heavily weighted stocks in the Indices represented 32.56% of the S&P/ASX 200 Index and 38.64% of the S&P/ASX 50 Index.^[4] The stocks comprising

the lowest 25% of both the S&P/ASX 200 Index and the S&P/ASX 50 Index had a six-month aggregate dollar value of average daily trading volume in excess of U.S. \$30 million: U.S. \$234 million and U.S. \$214 million, respectively, for the 6-month period ending January 31, 2002.^[5] The Indices are calculated in real time and are disseminated by electronic means through major data vendors in 30-second intervals.^[6]

ASXF's futures contracts on both Indices provide for cash settlement. The notional value for both futures contracts is determined by multiplying the relevant Index by 10 Australian dollars. Both futures contracts list for trading the months of the March quarterly cycle, and the last trading day for both futures contracts is the business day preceding the maturity date, which is the third Friday of the delivery month. Cash settlement occurs on the first business day after the maturity date. The final settlement price for each contract is calculated on the maturity date and is a special quotation of the relevant Index based on the opening prices of the relevant component stocks on the ASX on that day.^[7]

The Commodity Exchange Act ("CEA"),^[8] as amended by the Commodity Futures Modernization Act of 2000 ("CFMA"),^[9] 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,^[10] with the exception of security futures products,^[11] over which the Commission shares jurisdiction with the Securities and Exchange Commission ("SEC").^[12] 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).^[13]

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).^[14] 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 the trading of futures contracts on a group or index of securities on contract markets and derivatives transaction execution facilities ("DTFs"):

- (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.^[15]

While Section 2(a)(1)(C)(ii) provides that no board of trade or DTF may trade a stock index futures contract 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.^[16]

Accordingly, this Office has examined the S&P/ASX 200 Index and the S&P/ASX 50 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 S&P/ASX 200 Index and the S&P/ASX 50 Index, and ASXF's futures contracts based thereon, conform to these requirements.^[17]

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. As noted above, all the stocks underlying the Indices are traded on ASX. ASXF represents that ASX has access to information necessary to detect and deter manipulation of the underlying securities.^[18] The ASXF is a wholly-owned subsidiary of ASX, which supports ASXF in its regulation of its market.^[19] Both exchanges are regulated by the ASIC. Thus, ASXF should have access to information necessary to detect and deter manipulation.^[20] In the event that ASXF 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.^[21]

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 ASXF's futures contracts based on the S&P/ASX 200 Index and the S&P/ASX 50 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 ASXF with all regulatory requirements imposed by the ASIC, and the applicable laws and regulations of Australia. 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 ASXF's futures contracts on the S&P/ASX 200 Index and the S&P/ASX 50 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.^[22]

Sincerely,

Patrick J. McCarty

General Counsel

[1] See letter from Michael Roche, Executive General Manager, Market Services, ASXF, to David R. Merrill, Acting General Counsel, CFTC, dated March 13, 2002.

[2] See letter from Johanna Turner, Senior Lawyer, ASXF, to David R. Merrill, Deputy General Counsel, CFTC, dated April 23, 2002.

[3] *Id.*

[4] *Id.* Effective October 1, 2002, modifications to component stocks' capitalization weightings will be based on a "free-float" weighting system rather than the current liquidity factors. Under this system, capitalization weightings will be modified based on free-float; that is, that portion of capitalization that is not closely held, and thus, is freely available for trading on ASX. S&P is currently calculating and disseminating both the old liquidity-based versions of the Indices and the new free-float versions. Futures contracts expiring prior to October 1, 2002 will be based on the old version and futures contracts expiring after that date will be based on the new version. The concentration data mentioned above are based on the free-float versions of the Indices and are not materially different from those data for the liquidity-based versions of the Indices. See letter from Johanna Turner, Senior Lawyer, ASXF, to David R. Merrill, Deputy General Counsel, CFTC, dated May 16, 2002.

[5] See letter from Johanna Turner, Senior Lawyer, ASXF, to Julian E. Hammar, Attorney, CFTC, dated May 23, 2002.

[6] See letter from Mr. Roche to Mr. Merrill, dated March 13, 2002.

[7] *Id.*

[8] 7 U.S.C. § 1 *et seq.*

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

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

[11] 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).

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

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

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

[15] 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).

[16] 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.

[17] In making this determination, the staff has concluded that neither the S&P/ASX 200 Index nor the S&P/ASX 50 Index have any of the elements of a narrow-based security index as enumerated in CEA Section 1a(25)(A), and accordingly the Indices would not be narrow-based security indices if traded on a designated contract market or registered derivatives transaction execution facility.

[18] *See* letter from Mr. Roche to Mr. Merrill, dated March 13, 2002.

[19] *Id.* Separate business units within ASX have responsibility for investigations and enforcement and surveillance activity for both ASX and ASXF. The primary tool of market surveillance across ASX’s equity and futures markets is a specialized computer system, known as Surveillance of Market Activity

(“SOMA”), which continuously monitors all market activity and draws the attention of surveillance analysts to anything that might indicate irregular behavior. ASXF represents that SOMA surveillance by ASX will detect any unusual trading activity and that this information will be shared with ASXF. *Id.*

[20] In addition to its information-sharing arrangement with ASX, ASXF has entered into an information-sharing memorandum of understanding with the Sydney Futures Exchange, which trades a futures contract on the S&P/ASX 200. Information relating to either specific transactions or a series of transactions involving the futures contracts may be exchanged between the exchanges pursuant to this memorandum of understanding. *Id.*

[21] ASXF confirms that it is able to provide information to the Commission in relation to the trading of ASXF’s futures contracts on the Indices in accordance with the operation of its Business Rules. ASXF’s Business Rule 20.10.1(g) provides that ASXF may disclose information provided to it to any governmental agency or regulatory authority in Australia or elsewhere where the information relates either to the order and good government of market participants or the efficient, honest, fair, competitive and informed trading and clearing of derivatives or securities (in Australia or elsewhere). *See* letter from Mr. Roche to Mr. Merrill, dated March 13, 2002.

The Australian Securities Commission, predecessor to the ASIC, and the CFTC entered into a Memorandum of Understanding concerning Consultation and Cooperation in the Administration and Enforcement of Futures Laws on October 19, 1994 (“MOU”). The ASIC has confirmed that it has the necessary powers to obtain and provide market surveillance data regarding ASXF’s futures contracts on the Indices, and that it is willing to share that information with the CFTC pursuant to the terms of the MOU. *See* letter from Greg Tanzer, Executive Director, International Relations and Regional Coordination, ASIC, to David R. Merrill, Deputy General Counsel, CFTC, dated March 13, 2002. Moreover, the ASIC 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.

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