

**CFTC letter No. 03-07**  
**February 13, 2003**  
**No-Action**  
**Office of General Counsel**

Re: Singapore Exchange Derivatives Trading Limited's Request for No-action Relief to Offer and Sell its Futures Contract on the MSCI Japan Index in the United States

Dear Mr. Ang:

This is in response to your letters, attachments, facsimiles and electronic mail, dated from April 25, 2002 to August 1, 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 MSCI Japan Index ("MSCI Japan" or "Index"), traded on Singapore Exchange Derivatives Trading Limited ("SGX-DT").

We understand the facts to be as follows. SGX-DT, a wholly-owned subsidiary of Singapore Exchange, Limited ("SGX"), is a futures and options exchange located in Singapore.<sup>[1]</sup> SGX-DT and its parent company are both regulated by the Monetary Authority of Singapore ("MAS"), an independent governmental authority established under the Monetary Authority of Singapore Act. MAS is charged with, among other things, protecting customers and the integrity of Singapore securities and futures markets.

The MSCI Japan is a broad-based, modified capitalization-weighted composite security index computed by Morgan Stanley Capital International, Inc. ("MSCI"), and designed to be a benchmark index for the Japanese stock market.<sup>[2]</sup> MSCI's stated goal is for the Index to represent 85 percent of the free-float adjusted market capitalization of each industry group in Japan.<sup>[3]</sup> As of July 3, 2002, the MSCI Japan consisted of stocks of 321 of the largest companies, in terms of full market value, traded in Japan.<sup>[4]</sup> Based on data supplied by SGX-DT, the total market capitalization of the MSCI Japan was approximately U.S. \$1.990 trillion as of July 3, 2002.<sup>[5]</sup> As of that date, no single stock in the MSCI Japan represented more than 4.53% of the Index.<sup>[6]</sup> The five most heavily weighted stocks in the MSCI Japan represented 15.75% of the Index.<sup>[7]</sup> The stocks comprising the lowest 25% of the MSCI Japan had a six-month aggregate dollar value of average daily trading volume of U.S. \$1.461 billion for the six-month period ending in February 2002.<sup>[8]</sup> The Index is calculated in real time and is disseminated by electronic means through major data vendors in 15-second intervals.

SGX-DT's futures contract on the MSCI Japan, which was approved for listing by the MAS on February 21, 2002, provides for cash settlement. The notional value for the futures contract is determined by multiplying the Index by 5,000 Japanese Yen. SGX-DT lists for trading the five nearest months of the

March quarterly cycle, and the last trading day for the contract is the business day before the second Friday of the expiring contract month. Cash settlement occurs on the first business day after the last trading day. The final settlement price for the contract is calculated using a special opening quotation on the day after the last trading day.<sup>[9]</sup>

The Commodity Exchange Act (“CEA”),<sup>[10]</sup> as amended by the Commodity Futures Modernization Act of 2000 (“CFMA”),<sup>[11]</sup> provides that the offer or sale in the U.S. 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,<sup>[12]</sup> with the exception of security futures products,<sup>[13]</sup> over which the Commission shares jurisdiction with the Securities and Exchange Commission (“SEC”).<sup>[14]</sup> 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).<sup>[15]</sup>

CEA Section 2(a)(1)(C)(iv) generally prohibits any person from offering or selling a futures contract based on a security index in the U.S., except as permitted under CEA Section 2(a)(1)(C)(ii) or CEA Section 2(a)(1)(D).<sup>[16]</sup> By its terms, CEA Section 2(a)(1)(C)(iv) applies to futures contracts on security 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 security index.<sup>[17]</sup>

While Section 2(a)(1)(C)(ii) provides that no board of trade or DTF may trade a security index futures contract unless it meets the three criteria noted above, it does not explicitly address the standards to be applied to a foreign security 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 security 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.<sup>[18]</sup>

Accordingly, this Office has examined the MSCI Japan 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 MSCI Japan, and SGX-DT’s futures contract based thereon, conform to these requirements.<sup>[19]</sup>

In determining whether a foreign exchange-traded futures contract based on a 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 securities underlying the Index. With the exception of one security, all of the component securities in the Index are traded on the Tokyo Stock Exchange ("TSE").<sup>[20]</sup> SGX-DT has entered into a Strategic Alliance Agreement with TSE.<sup>[21]</sup> The nature of this agreement is to broaden the distribution of and to enhance the liquidity of products on both SGX's and TSE's respective securities and derivatives markets. Pursuant to this agreement, SGX-DT and TSE have agreed to use reasonable endeavors to exchange information with each other, although the agreement does not specify access to the identity of the ultimate customer to a transaction in securities underlying the Index as information to be exchanged. Should the need arise, SGX-DT will request such information from TSE. In addition, the governments of Japan and Singapore have signed the Japan-Singapore Economic Agreement for a New Age Partnership to cooperate in various areas. Pursuant to this agreement, Japan and Singapore will cooperate in sharing information on securities and securities derivatives markets of their respective countries with the aim of contributing to the effective enforcement of the securities laws of each country.<sup>[22]</sup>

In consideration of the information-sharing arrangements to which SGX-DT and the government of Singapore respectively are parties, as noted herein, this Office has concluded that SGX-DT should have access to the information necessary to detect and deter manipulation. In the event that SGX-DT 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.<sup>[23]</sup>

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 SGX-DT's futures contract based on the MSCI Japan 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 SGX-DT with all regulatory requirements imposed by the MAS, and the applicable laws and regulations of Singapore. In addition, this position may be affected by any rules that the Commission may adopt regarding futures contracts based on non-narrow-based security indices.

The offer and sale in the U.S. of SGX-DT's futures contract on the MSCI Japan is, of course, subject to Part 30 of the Commission's regulations, which governs the offer and sale of foreign futures and foreign option contracts in the U.S.<sup>[24]</sup>

Sincerely,

Patrick J. McCarty

General Counsel

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[1] For a description of the formation of SGX and its subsidiaries, *see* CFTC letter No. 00-77, [1999-2000 Transfer Binder] Comm. Fut. L Rep. (CCH) ¶ 28,182 (June 21, 2000).

[2] *See* letter from Jimmy Ang, Executive Vice President, SGX-DT, to Patrick J. McCarty, General Counsel, CFTC, dated April 25, 2002. SGX-DT has signed a licensing agreement with MSCI under which SGX-DT was granted a license by MSCI to trade futures and options contracts based on the MSCI Japan Index. *Id.*

[3] *Id.*

[4] *See* letter from Jimmy Ang, Executive Vice President, SGX-DT, to David R. Merrill, Deputy General Counsel, CFTC, dated August 1, 2002.

[5] *Id.*

[6] *Id.*

[7] *Id.*

[8] *Id.*

[9] *See* letter from Mr. Ang to Mr. McCarty, dated April 25, 2002.

[10] 7 U.S.C. § 1 *et seq.*

[11] Appendix E of Pub. L. No. 106-554, 114 Stat. 2763 (2000).

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

[13] 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).

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

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

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

[17] 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).

[18] 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.

[19] In making this determination, the Commission staff has concluded that the MSCI Japan 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 DTF.

[20] The one security not traded on the TSE, Fuji Machine Manufacturing Company, is traded on the Nagoya Stock Exchange (“NSE”) and the Osaka Securities Exchange (“OSE”) and constitutes only 0.0415% of the Index’s weighting. See letter from Mr. Ang to Mr. Merrill, dated August 1, 2002. With regard to the remaining stocks in the Index, 307 out of 321 of the component securities have their primary listing on the TSE, while 13 stocks have their primary listing on the OSE and 1 stock has its primary listing on the NSE. Stocks with their primary listing on the latter two exchanges represent only 4.19% of the Index’s weighting. *Id.*

[21] *Id.*

[\[22\]](#) See letter from Mr. Ang to Mr. McCarty, dated April 25, 2002.

[\[23\]](#) SGX-DT confirms that it would cooperate with the Commission in any inquiry, investigation, and/or enforcement proceeding relating to the offer and sale of its futures contract on the MSCI Japan in the U. S. See letter from Mr. Ang to Mr. McCarty, dated April 25, 2002. In addition, the CFTC has granted Regulation 30.10 relief to SIMEX, SGX-DT's predecessor. See Appendix C to Commission Regulation 30.10, 17 C.F.R. § 30.10. Further, SGX-DT is a signatory to the International Information Sharing Memorandum of Understanding and Agreement signed on March 15, 1996, at Boca Raton, Florida.

On May 16, 2000, a Memorandum of Understanding ("MOU") was entered into by SGX-DT's regulator, the MAS, 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. Moreover, MAS is a signatory to the Declaration on Cooperation and Supervision of International Futures Markets and Clearing Organizations, signed on March 15, 1996, at Boca Raton, Florida.

[\[24\]](#) See 17 C.F.R. Part 30.