



## U.S. COMMODITY FUTURES TRADING COMMISSION

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Office of General Counsel

CFTC letter No. 04-05  
January 22, 2004  
No-Action  
Office of General Counsel

Mr. Laurence Walton  
Head of Market Secretariat  
The London International Financial Futures and Options Exchange  
Administration and Management  
Cannon Bridge House  
1 Cousin Lane  
London EC4R 3XX  
United Kingdom

Re: The London International Financial Futures and Option Exchange  
Administration and Management's Request for No-Action Relief in  
Connection with the Offer and Sale of its Futures Contracts Based on the  
FTSEurofirst 80 Index and the FTSEurofirst 100 Index in the United States

Dear Mr. Walton:

This is in response to letters, attachments, facsimiles and electronic mail dated from June 23, 2003 to November 17, 2003, requesting that the Office of General Counsel ("Office") of the Commodity Futures Trading Commission ("Commission" or "CFTC") issue to The London International Financial Futures and Option Exchange Administration and Management ("LIFFE"), which operates the LIFFE market, a "no-action" letter concerning the offer and sale in the United States ("U.S.") of LIFFE's futures contracts based on the FTSEurofirst 80 Index ("FTSEurofirst 80") and the FTSEurofirst 100 Index ("FTSEurofirst 100") (collectively, "Indices").

We understand the facts to be as follows. LIFFE operates the LIFFE market, a futures and options exchange located in the United Kingdom ("U.K.") that is regulated by the Financial Services Authority ("FSA"). The FSA is the single regulator in the U.K. responsible for the investment business, including the regulation of commodity futures and options markets and intermediaries.<sup>1</sup>

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<sup>1</sup> The Commission recently reviewed changes to the regulatory structure in the U.K. in conjunction with consolidating and updating the relief set forth in prior orders issued pursuant to Commission Rule 30.10 to reflect the substitution of the FSA for various U.K. regulatory and self-regulatory organizations. See 68 FR 58583 (Oct. 10, 2003).

The FTSEurofirst 80 and the FTSEurofirst 100 are broad-based, free-float market capitalization-weighted composite indices of highly capitalized and actively traded securities currently listed on major European stock exchanges.<sup>2</sup> The FTSEurofirst 80 is designed to consist of 80 securities representing the overall performance of companies traded on exchanges in countries that are in the European Monetary Union (“EMU”). The FTSEurofirst 100 is designed to consist of 100 securities reflecting the overall performance of companies traded on exchanges in the EMU plus the U.K. Both Indices are owned and managed by FTSE International, Limited.<sup>3</sup>

Based on data supplied by LIFFE, the total market capitalizations of the FTSEurofirst 80 and FTSEurofirst 100 were approximately U.S.\$ 1,744 billion and U.S.\$ 2,881 billion, respectively, as of June 10, 2003.<sup>4</sup> Also as of that date, the largest single security by weight represented 6.03% of the FTSEurofirst 80 and 5.53% of the FTSEurofirst 100.<sup>5</sup> The five most heavily weighted securities represented 22.61% of the FTSEurofirst 80 and 22.88 % of the FTSEurofirst 100.<sup>6</sup> The securities comprising the lowest 25% of both Indices had six-month aggregate dollar values of average daily trading volume in excess of U.S. \$30 million: approximately U.S.\$ 2.8 billion for the FTSEurofirst 80 and U.S.\$ 4.3 billion for the FTSEurofirst 100 for the 6-month period ending May 2003.<sup>7</sup> Both indices are calculated in real time and are disseminated by electronic means through major data vendors, such as Bloomberg and Reuters.<sup>8</sup>

With the exception of the index underlying each futures contract, the terms and conditions for LIFFE’s contracts on the Indices are identical. Both contracts provide for cash settlement. Prices are quoted in index points with each index point equal to 10 euros per contract. The minimum price fluctuation is one index point per contract. The

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<sup>2</sup> The current constituent securities of the FTSEurofirst 80 are traded on six European stock exchanges: the Borsa Italiana (Italy), Deutsche Börse AG (Germany), Euronext Amsterdam (The Netherlands), Euronext Paris (France), Helsinki Stock Exchange (Finland) and the Madrid Stock Exchange (Spain). The FTSEurofirst 100 includes securities traded on those six exchanges plus the London Stock Exchange (U.K.). See letter from Laurence Walton, Head of Market Secretariat, LIFFE to Harold L. Hardman, Senior Assistant General Counsel (Regulation), CFTC, dated June 23, 2003.

<sup>3</sup> *Id.*

<sup>4</sup> *Id.*

<sup>5</sup> *Id.*

<sup>6</sup> *Id.*

<sup>7</sup> *Id.*

<sup>8</sup> *Id.*

contracts are listed for trading from 9:00 a.m. to 8:00 p.m. Central European Time on LIFFE's electronic trading system, LIFFE CONNECT®. LIFFE lists for trading the three nearest months of the March quarterly cycle. The last trading day is the third Friday of the delivery month. Cash settlement occurs on the first business day after the last trading day. The final cash settlement price for the contracts is calculated on the last day of trading and is the arithmetic mean of the relevant index's levels that are calculated and disseminated every fifteen seconds between 10:50 and 11:00 a.m., Central European Time, inclusive (41 values).<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

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<sup>9</sup> *Id.*

<sup>10</sup> 7 U.S.C. § 1 *et seq.*

<sup>11</sup> Appendix E of Pub. L. No. 106-554, 114 Stat. 2763 (2000).

<sup>12</sup> See CEA Section 2(a)(1)(C)(ii).

<sup>13</sup> 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).

<sup>14</sup> See CEA Section 2(a)(1)(D).

<sup>15</sup> See CEA Section 2(a)(1)(C)(ii).

<sup>16</sup> CEA Section 2(a)(1)(D) governs the offer and sale of security futures products.

the trading of futures contracts on a group or index of securities on designated contract markets and registered derivatives transaction execution facilities (“DTEFs”):

- (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 DTEF 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 U.S. 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 DTEF to trade those products.<sup>18</sup>

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<sup>17</sup> 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).

<sup>18</sup> 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.

Accordingly, this Office has examined the FTSEurofirst 80 and FTSEurofirst 100, and LIFFE's 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 the Indices and LIFFE's futures contracts based thereon conform to these requirements.<sup>19</sup>

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 securities underlying the index. All of the countries represented in the Indices are Member States of the European Union ("EU"). LIFFE represents that the Investment Services Directive of the EU ("ISD"), to which all of the countries represented in the Indices are subject, provides a comprehensive system of cooperation and information sharing among authorities that are responsible for regulating financial services, including futures, options and securities dealing, within the EU.<sup>20</sup> Article 23.3 of the ISD stipulates that where an investment firm operates in one or more Member States of the EU in addition to its home Member State, the regulatory authorities of the Member States concerned must collaborate closely in order to discharge their responsibilities. LIFFE represents that Article 23.3 would apply with respect to firms that deal in the FTSEurofirst 80 and FTSEurofirst 100 futures contracts and in the underlying equities.<sup>21</sup> Moreover, Article 25.5(b) of the ISD allows a Member State's regulatory authority to pass information to other bodies that are responsible for the supervision of financial markets. LIFFE represents that such bodies would include investment exchanges such as LIFFE.<sup>22</sup> Thus, LIFFE should have access to information necessary to detect and deter manipulation. In the event that LIFFE 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>

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<sup>19</sup> In making this determination, the Commission staff has concluded that neither the FTSEurofirst 80 nor the FTSEurofirst 100 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 DTEF.

<sup>20</sup> See letter from Mr. Walton to Mr. Hardman, dated June 23, 2003.

<sup>21</sup> *Id.*

<sup>22</sup> *Id.*

<sup>23</sup> LIFFE confirms that, once approved, the FTSEurofirst 80 and FTSEurofirst 100 futures contracts would be subject to all terms and conditions contained in the Foreign Trading System No-Action Letter issued to LIFFE, CFTC Letter No. 99-31 [1998-1999 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 27,744 (July 23, 1999), and that therefore

In light of the foregoing, this Office 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 LIFFE's futures contracts on the FTSEurofirst 80 and FTSEurofirst 100 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 LIFFE with all regulatory requirements imposed by FSA, and the applicable laws and regulations of the U.K. 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.

Separately, by letter dated June 23, 2003, LIFFE requested that the Division of Market Oversight ("Division") grant supplemental no-action relief to make the FTSEurofirst 80 and the FTSEurofirst 100 futures contracts available for trading pursuant to the Foreign Trading System No-Action Letter issued to LIFFE on July 23, 1999.<sup>24</sup> The Division has authorized us to inform you that it has reviewed and considered your request for supplemental relief and the representations forwarded to the Division in support of that request. Based specifically upon these representations, the Division has determined that granting supplemental relief to LIFFE would not be

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the existing arrangements whereby LIFFE has agreed to share information with the CFTC either directly, or indirectly through the FSA, would apply equally to these contracts. See letter from Laurence Walton, Head of Market Secretariat, LIFFE to Harold L. Hardman, Senior Assistant General Counsel (Regulation), CFTC, dated October 20, 2003. LIFFE also is a signatory to the International Information Sharing Memorandum of Understanding and Agreement signed on March 15, 1996, at Boca Raton, Florida.

On September 25, 1991, a Memorandum of Understanding was entered into by the U.K. Department of Trade and Industry and the Securities Investment Board ("SIB"), the FSA's predecessor agency, 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 ("U.S./U.K. MOU"). LIFFE represents that the U.S./U.K. MOU would also facilitate the sharing of information with respect to LIFFE's contracts on the Indices. In addition, as noted above, the CFTC has granted Regulation 30.10 relief to the FSA. See Appendix C to Commission Regulation 30.10, 17 C.F.R. § 30.10. The FSA also is a signatory to the International Organization of Securities Commission's Multilateral Memorandum of Understanding Concerning Consultation and Cooperation and the Exchange of Information (May 2002) ("IOSCO MOU") and the Declaration on Cooperation and Supervision of International Futures Exchanges and Clearing Organizations, as amended, signed on March 15, 1996 at Boca Raton, Florida.

<sup>24</sup> CFTC Letter No. 99-31 [1998-1999 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 27,744 (July 23, 1999).

contrary to the public interest. Accordingly, on behalf of the Division, this Office hereby confirms that the no-action relief granted to LIFFE in the July 23, 1999 no-action letter extends to the FTSEurofirst 80 and the FTSEurofirst 100 futures contracts.

The offer and sale in the U.S. of LIFFE's futures contracts on the Indices 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>25</sup>

Sincerely,

Patrick J. McCarty  
General Counsel

cc: Michael M. Philipp, Esq.  
Katten Muchin Zavis Rosenman

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<sup>25</sup> See 17 C.F.R. Part 30.