



U.S. COMMODITY FUTURES TRADING COMMISSION

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Office of General Counsel

CFTC letter No. 0-23
November 23, 2005
No-Action
Office of General Counsel

Edward J. Rosen, Esq.
Cleary, Gottlieb, Steen & Hamilton LLP
One Liberty Plaza
New York, NY 10006-1470

Re: Eurex Deutschland's Request for No-Action Relief in Connection with the Offer and Sale in the United States of its Dow Jones Italy Titans 30 Index Futures Contract

Dear Mr. Rosen:

This is in response to letters, attachments, facsimiles and electronic mail dated from September 23, 2004 to April 25, 2005, requesting on behalf of your client, Eurex Deutschland ("Eurex"), 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 ("US") of Eurex's futures contract based on the Dow Jones Italy Titans 30 Index ("DJIT 30" or "Index").

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.¹ Eurex is regulated by and subject to active market surveillance by German regulatory agencies, including the Exchange Supervisory Authority in the State of Hesse, where Eurex and the Frankfurt Stock Exchange are located, and by the German Federal Financial Supervisory Agency (Bundesanstalt für Finanzdienstleistungsaufsicht) (the

¹ This Office previously has granted no-action relief to Eurex in connection with the offer and sale in the US of its futures contracts based on the Dow Jones Global Titans 50 Index, see CFTC Staff Letter No. 02-81 [2002-2003 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 29,094 (June 28, 2002); the STOXX 600 Banking Sector Index and EURO STOXX Banking Sector Index, see CFTC Staff Letter No. 02-38 [2002-2003 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 28,999 (April 2, 2002); the STOXX 50 Index and the EURO STOXX 50 Index, see CFTC Staff Letter No. 00-52 [1999-2000 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 28,114 (April 6, 2000) and the DAX Index, see CFTC Staff Letter No. 94-98 [1994-1996 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 26,277 (Dec. 20, 1994).

“BaFin”).² Pursuant to the German Securities Trading Act, the BaFin 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.³

The DJIT 30 is a broad-based, free-float market capitalization-weighted index maintained by Dow Jones Indexes (“Dow Jones”), a part of Dow Jones & Company, Inc.⁴ The DJIT 30 generally consists of the largest and most liquid 30 securities in the Dow Jones Global Index country-level index for Italy, the Dow Jones Italy Index, which consists of companies with a primary listing on the Italian Stock Exchange (“ISE”). The composition of the DJIT 30 is reviewed annually in March. Selection of the securities of the DJIT 30 is a multi-stage process. First, the top 60 companies in the Dow Jones Italy Index by free-float market capitalization are selected monthly and form a selection list. Second, securities on the selection list are ranked first by size (free-float market capitalization) and then by liquidity (12 month average daily trading volume). A final ranking for each security is then created based equally on the capitalization ranking and the liquidity ranking. The Index generally consists of the top 30 securities by the final ranking.⁵

² On May 1, 2002, the Federal Banking Supervisory Office (Bundesaufsichtsamt für das Kreditwesen) (“BAKred”), the Federal Securities Supervisory Office (Bundesaufsichtsamt für den Wertpapierhandel) (“BAWe”) and the Federal Insurance Supervisory Office (Bundesaufsichtsamt für das Versicherungswesen) (“BAV”) were merged into the BaFin, which has federal responsibility for the supervision of credit institutions, financial services institutions and insurance companies. All activities previously regulated by the BAKred, the BAWe and the BAV are now regulated by the BaFin. See letter from Edward J. Rosen, Esq., Cleary Gottlieb Steen & Hamilton, LLP, to Patrick J. McCarty, General Counsel, CFTC, dated September 23, 2004, at 7.

³ *Id.*

⁴ *Id.* at 4.

⁵ *Id.* at 5. At each annual review, if a security that is not currently in the DJIT 30 is among the top 25 securities by final ranking, it replaces the lowest ranking security in the DJIT 30. If a security is currently in the DJIT 30 but is not among the top 35 stocks by final ranking, it is replaced by the highest ranking security in the selection list not currently in the DJIT 30. Notification of changes to the Index composition is generally made two weeks prior to implementation, which occurs as of the first trading day following the third Friday in March. In addition, the weighting of component securities is evaluated on a quarterly basis in March, June, September and December based on changes in free-float market capitalization, and if the weight of any component security exceeds 10% of the Index at the quarterly review, it is reduced to 10%. The DJIT 30’s composition also may be adjusted at other times for extraordinary corporate events,

Based on data supplied by Eurex, the total adjusted market capitalization of the DJIT 30 was approximately US\$ 332.3 billion as of March 15, 2005.⁶ Also as of that date, the largest single security by weight represented 10.57%, and the five most heavily weighted securities represented 47.91%, of the DJIT 30.⁷ The securities comprising the lowest 25% of the Index had a six-month aggregate dollar value of average daily trading volume in excess of US\$ 30 million: approximately US\$ 609 million for the 6-month period ending January 2005.⁸ The Index is calculated in real time and is disseminated by electronic means through major data vendors, such as Bloomberg and Reuters.⁹

Eurex's DJIT 30 futures contract provides for cash settlement.¹⁰ Prices are quoted in Index points with each Index point equal to 10 euros per contract. The minimum price movement is one Index point. Eurex lists for trading the three nearest months of the March quarterly cycle (March, June, September and December). The last trading day of the contract is the third Friday of the relevant expiration month (or, if such day is not a trading day, the trading day immediately preceding such Friday). Cash settlement occurs on the first trading day after the last trading day of the contract. The final cash settlement price for the contract is calculated based on the opening prices at the ISE of the shares in the DJIT 30 on the last trading day.¹¹

The Commodity Exchange Act ("CEA"),¹² as amended by the Commodity Futures Modernization Act of 2000 ("CFMA"),¹³ 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

including spinoffs, mergers, delistings and bankruptcies. Notice of these changes is made at least two days prior to their implementation where possible. *Id.* at 5-6.

⁶ See letter from Geoffrey B. Goldman, Esq., Cleary Gottlieb Steen & Hamilton, LLP, to David R. Merrill, Deputy General Counsel, CFTC, dated April 25, 2005, Annex D.

⁷ *Id.*

⁸ *Id.*

⁹ See letter from Mr. Rosen to Mr. McCarty, dated September 23, 2004, at 6.

¹⁰ *Id.* at 8.

¹¹ *Id.*

¹² 7 U.S.C. § 1 *et seq.*

¹³ Appendix E of Pub. L. No. 106-554, 114 Stat. 2763 (2000).

Commission's exclusive jurisdiction,¹⁴ with the exception of security futures products,¹⁵ over which the Commission shares jurisdiction with the Securities and Exchange Commission ("SEC").¹⁶ 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).¹⁷

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 United States, except as permitted under CEA Section 2(a)(1)(C)(ii) or CEA Section 2(a)(1)(D).¹⁸ 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 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.¹⁹

¹⁴ See CEA Section 2(a)(1)(C)(ii).

¹⁵ 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).

¹⁶ See CEA Section 2(a)(1)(D).

¹⁷ See CEA Section 2(a)(1)(C)(ii).

¹⁸ CEA Section 2(a)(1)(D) governs the offer and sale of security futures products.

¹⁹ 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

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 US 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.²⁰

Accordingly, this Office has examined the DJIT 30, and Eurex's 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 DJIT 30, and Eurex's futures contract based thereon, conform to these requirements.²¹

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. As noted above, all of the stocks underlying the DJIT 30 are traded on the ISE. Eurex represents that the ISE is subject to active market surveillance by the Borsa Italiana, S.p.A. ("Borsa"), which manages the ISE, and the Commissione Nazionale per le Società e la Borsa

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).

²⁰ 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.

²¹ In making this determination, the Commission staff has concluded that the DJIT 30 does not have any of the elements of a narrow-based security index as enumerated in CEA Section 1a(25)(A), and accordingly the Index would not be a narrow-based security index if traded on a designated contract market or DTEF.

("Consob"), the Italian government regulator. Eurex further represents that BaFin generally has access to surveillance data from those regulators with respect to the trading of the DJIT 30 component stocks pursuant to information-sharing Memoranda of Understanding ("MOUs").

In particular, the members of the Forum of European Securities Commissions, which includes German and Italian government regulators, entered into a Multilateral Memorandum of Understanding on the Exchange of Information and Surveillance Activities (the "FESCO MOU"). Eurex represents that the FESCO MOU provides for sharing of certain market surveillance data among FESCO members, including the identity of the ultimate customer in a transaction.²² The BaFin and its predecessor, the BAWe, have also entered into bilateral MOUs with regulators in a number of countries, including Italy.²³ Moreover, the BaFin, as well as the Consob, are signatories to the International Organization of Securities Commission's Multilateral Memorandum of Understanding Concerning Consultation and Cooperation and the Exchange of Information of the International Organization of Securities Commissions ("IOSCO MOU"). Eurex represents that it may request that the BaFin obtain information pursuant to the information sharing arrangements described above, as necessary.²⁴ Pursuant to Section 7 of the German Securities Trading Act, the BaFin may share information communicated to the BaFin by authorities in other countries with the exchange supervisory authorities and the market supervision units of German exchanges, including Eurex, in accordance with the purposes for which such information was shared with the BaFin.²⁵ Moreover, 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.²⁶

²² See letter from Mr. Rosen to Mr. McCarty, dated September 23, 2004, at 7. Pursuant to the FESCO MOU, European regulators agreed to provide each other with "the fullest mutual assistance" in matters falling within the competence of the member regulators, including "investigations and enforcement in connection with applicable laws or regulations relating to insider dealing, market manipulation and other fraudulent or manipulative practices in the securities field." See letter from Mr. Goldman to Mr. Merrill, dated April 25, 2005, at 3.

²³ See letter from Mr. Rosen to Mr. McCarty, dated September 23, 2004, at 7.

²⁴ *Id.* at 8.

²⁵ See letter from Mr. Goldman to Mr. Merrill, dated April 25, 2005, at 4.

²⁶ See letter from Mr. Rosen to Mr. McCarty, dated September 23, 2004, at 8.

Thus, in light of these information-sharing arrangements, Eurex should have access to information necessary to detect and deter manipulation.²⁷ In the event that Eurex is unable to obtain access to adequate surveillance data in this regard, or is unable, either directly or through the BaFin, to share such data with the CFTC, this Office reserves the right to reconsider the position we have taken herein.²⁸

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 Eurex's futures contract based on the DJIT 30 is offered or sold in the US. 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 BaFin, 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 security indices.

Eurex also has requested that, upon issuance of the relief granted herein, it be permitted to make the DJIT 30 futures contract available for trading through the electronic trading terminals of its US members in accordance with the terms of the

²⁷ We note that in a recent SEC staff no-action letter to permit, among other things, Eurex and its participants to familiarize Eligible Broker-Dealers and Eligible Institutions in the United States with Options traded on Eurex without Eurex or Eurex participants registering with the SEC, SEC Staff cited, in the absence of formal exchange-to-exchange surveillance sharing agreements between non-German exchanges, Eurex's representations regarding the FESCO MOU and the Trading Surveillance Office's authority to request surveillance information, respectively, in issuing the requested relief. See Eurex, SEC Division of Market Regulation No-Action Letter, 2005 WL 1844502 at *17 (July 27, 2005).

²⁸ In this regard, Eurex has confirmed 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 DJIT 30 futures contract. See letter from Mr. Rosen to Mr. McCarty, dated September 23, 2004, at 8. Eurex also is a signatory to the International Information Sharing Memorandum of Understanding and Agreement signed on March 15, 1996, at Boca Raton, Florida. In addition, the BaFin's predecessor, 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. Moreover, as noted above, the BaFin is a signatory to the IOSCO MOU, to which the Commission also is a signatory, and the BaFin, through its predecessor, is a signatory to the Declaration on Cooperation and Supervision of International Futures Exchanges and Clearing Organizations for the sharing of large exposure information, signed on March 15, 1996, at Boca Raton, Florida.

August 10, 1999 foreign terminals no-action letter (“August 10, 1999 letter”) issued by Commission staff to Eurex.²⁹ In this regard, Eurex has certified that it is in compliance with the terms of the August 10, 1999 letter and that Eurex’s futures contract on the DJIT 30 will be traded in accordance with the terms and conditions of the August 10, 1999 letter.³⁰ We have consulted with the Commission’s Division of Market Oversight (“Division”), which is the Division in the Commission that administers foreign terminal no-action letters. The Division has concluded that allowing Eurex to make its DJIT 30 futures contract available for trading pursuant to the August 10, 1999 letter would not be contrary to the public interest. Accordingly, on behalf of the Division, this Office hereby confirms that the no-action relief granted to Eurex in the August 10, 1999 letter extends to the Eurex’s DJIT 30 futures contract.

The offer and sale in the US of Eurex’s futures contract on the DJIT 30 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 US.³¹

Sincerely,

/s/

Nanette R. Everson
General Counsel

²⁹ See CFTC Staff Letter No. 99-48 [1999-2000 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 27.572 (Aug. 10, 1999).

³⁰ See letter from Mr. Rosen to Mr. McCarty, dated September 23, 2004, at 2.

³¹ See 17 C.F.R. Part 30.