



U.S. COMMODITY FUTURES TRADING COMMISSION

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Office of General Counsel

CFTC letter No. 06-17
August 8, 2006
No-Action
Office of General Counsel

Mr. Malcolm Starr
General Counsel and Company Secretary
Sydney Futures Exchange Corporation Limited
30 Grosvenor Street
Sydney NSW 2000
AUSTRALIA

Re: No-Action Request to Permit the Offer and Sale in the United States of the Sydney Futures Exchange Corporation Limited's 1-Day Option Contract based on the CBOT Mini-Sized Dow Futures Contract

Dear Mr. Starr:

This is in response to letters, attachments, facsimiles and electronic mail dated from December 14, 2005 to April 10, 2006, 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 the Sydney Futures Exchange Corporation Limited's ("SFE's") 1-Day Option Contract based on the CBOT Mini-Sized Dow Futures Contract.

We understand the facts to be as follows. The SFE is a self-regulating exchange in Australia with systems for audit, market surveillance and compliance.¹ The SFE is under the regulatory jurisdiction of the Australian Securities and Investments Commission ("ASIC"). The ASIC administers Chapter 7 of the Australian Corporations Act governing the operation of financial services and markets in Australia.²

¹ This Office previously has granted no-action relief to SFE in connection with the offer and sale in the U.S. of futures contracts based on the All Ordinaries Share Price Index, see CFTC Staff Letter No. 91-1, [1990-1992 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 25,122 (Aug. 29, 1991), and the S&P/Australian Stock Exchange 200 Index, see CFTC Staff Letter No. 00-103, [2000-2002 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 28,428 (Nov. 13, 2000).

² See letter from Malcolm Starr, General Counsel & Secretary, SFE to Patrick J. McCarty, General Counsel, CFTC, dated December 14, 2005, at 3.

The SFE has entered into a license agreement with the Chicago Board of Trade (“CBOT”) for the provision and use of the CBOT Mini-Sized Dow Futures Contract daily settlement price to cash settle SFE’s 1-Day Option Contract. The CBOT’s Mini-Sized Dow Futures Contract is based on the Dow Jones Industrial Average Index (“DJIA”). The DJIA is a broad-based price-weighted index of 30 stocks chosen by Dow Jones and Company to reflect different industrial sectors of the economy. Those stocks typically are sector-leading companies that rank among the largest companies in the world by market capitalization. The DJIA is widely available via electronic and print media.

The CBOT filed on January 8, 2004 a certification, pursuant to CEA Section 5c(c)(1) and Commission regulation 40.2, that the terms and conditions of its Mini-Sized Dow Futures Contract comply with the CEA and regulations thereunder. The terms and conditions of CBOT’s Mini-Sized Dow Futures Contract generally are identical to the terms and conditions of CBOT’s standard-sized DJIA futures contract, the major difference being that the Mini-Sized Dow Futures Contract has a smaller contract size--\$5.00 times the DJIA, which is one-half that of CBOT’s standard-sized DJIA futures contract. Moreover, although both contracts share the same size minimum tick, the value of the minimum tick for the Mini-Sized Dow Futures Contract is one-half of the value of the minimum tick for the standard-sized DJIA futures contract. All other contract terms and conditions are identical.

SFE’s 1-Day Option Contract on the CBOT Mini-Sized Dow Futures Contract has a product life of less than one day, specifically 16 to 18 hours depending on standard time and daylight saving time in Australia and Chicago.³ The 1-Day Option Contract is cash settled daily by the Sydney Futures Exchange Clearing Corporation (“SFEC”) based on the daily settlement price of the nearby CBOT Mini-Sized Dow Futures Contract, provided by CBOT to SFE.⁴ The SFE’s 1-Day Option Contract on the nearby CBOT Mini-Sized Dow Futures contract is available for trading until five days prior to expiration of the underlying futures contract, after which the Option Contract will be available for the second quarter month ahead.⁵ All in-the-money option contracts are cash-settled automatically upon expiration. Since March 20, 2006, the daily settlement price for the Mini-Sized Dow Futures contract has been the weighted average (rounded to the nearest tick) of transaction prices between 3:14 p.m. and 3:15 p.m. Chicago time. If the CBOT does not provide a settlement price for a particular trading day, the settlement price will be calculated using the volume weighted average price over the

³ See letter from Mr. Starr to Mr. McCarty, dated December 14, 2005, at 2. There is no automatic “roll” of the option: a new order will need to be placed each day to secure a new option. *Id.*

⁴ *Id.* at 3.

⁵ *Id.* In this way, the SFE’s 1-Day Option Contract for the current month of the CBOT Mini-Sized Dow Futures Contract will not expire on the same day as the underlying futures contract.

last ten minutes of trading prior to the market halt or system failure (if the market halt or system failure occurred less than two hours prior to the scheduled close of trading).⁶ In the event that trading in the CBOT Mini-Sized Dow Futures Contract is halted pursuant to a circuit breaker trading halt rule, the SFE will suspend trading of its 1-Day Option Contract.

The Commodity Exchange Act (“CEA”),⁷ as amended by the Commodity Futures Modernization Act of 2000 (“CFMA”),⁸ provides that the offer or sale in the U.S. of futures contracts (and options thereon) 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,⁹ with the exception of security futures products,¹⁰ over which the Commission shares jurisdiction with the Securities and Exchange Commission (“SEC”).¹¹ 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).¹²

CEA Section 2(a)(1)(C)(iv) generally prohibits any person from offering or selling a futures contract (or option on such 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).¹³ By

⁶ See electronic mail from Philip McBride Johnson, Esq., Skadden, Arps, Slate, Meagher & Flom LLP, to David R. Merrill, Deputy General Counsel, CFTC, dated April 10, 2006. If a settlement price can not be calculated from that procedure or if the market halt occurred two or more hours prior to the scheduled close of trading, the SFE will calculate the settlement price as the mid point of the last bid and offer immediately preceding the market halt. If neither of these methods of calculating the settlement price is available or valid, the SFE will use the last traded price of the CBOT Mini-Sized Dow Futures Contract.

⁷ 7 U.S.C. § 1 *et seq.*

⁸ Appendix E of Pub. L. No. 106-554, 114 Stat. 2763 (2000).

⁹ See CEA Section 2(a)(1)(C)(ii).

¹⁰ 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).

¹¹ See CEA Section 2(a)(1)(D).

¹² See CEA Section 2(a)(1)(C)(ii).

¹³ CEA Section 2(a)(1)(D) governs the offer and sale of security futures products.

its terms, CEA Section 2(a)(1)(C)(iv) applies to futures contracts on security indices and options thereon 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 and options thereon on a group or index of securities and options on such contracts 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.

While CEA Section 2(a)(1)(C)(ii) provides that no board of trade or DTEF may trade a security index futures contract or option thereon unless the contract meets the three criteria noted above, it does not explicitly address the standards to be applied to a security index futures contract or option thereon 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.¹⁴

Ordinarily, this Office issues a no-action letter to a foreign board of trade for a futures contract based on a foreign broad-based security index. Once no-action relief has been granted for the underlying futures contract, no further action is required by this Office in order for an option on such a futures contract to be offered and sold in the U.S.¹⁵ However, in this case, because the underlying futures contract is listed and traded on the CBOT, rather than the SFE, the SFE has applied for no-action relief with regard to SFE’s product, the 1-Day Option Contract. Accordingly, this Office has applied the three criteria noted above in order to determine whether the DJIA, the

¹⁴ See also CFTC Rule 41.13 and Rule 3a55-3 under the Securities Exchange Act of 1934 (“Exchange Act”), rules jointly promulgated by the CFTC and SEC to govern security index futures contracts traded on foreign boards of trade, which 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.

¹⁵ See 61 Fed. Reg. 10891 (March 18, 1996).

CBOT's Mini-Sized Dow Futures Contract, and SFE's 1-Day Option based thereon meet the requirements enumerated in CEA Section 2(a)(1)(C)(ii).¹⁶ 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 DJIA, CBOT's Mini-Sized Dow Futures Contract and SFE's 1-Day Option Contract based thereon, conform to these requirements.¹⁷

In determining whether an option on a 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. Pursuant to the license agreement between the CBOT and SFE, both exchanges have agreed to cooperate, to the fullest extent permitted by applicable law, in conducting market surveillance activities with regard to SFE's 1-Day Option Contract and CBOT's Mini-Sized Dow Futures Contract. Thus, SFE should have access to information necessary to detect and deter manipulation. In the event that SFE 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.¹⁸

¹⁶ As noted above, the CBOT has certified that its Mini-Sized Dow Futures Contract complies with the CEA and regulations thereunder.

¹⁷ In making this determination, Commission staff has concluded that the DJIA is not a narrow-based security index because the Commission approved the CBOT to list for trading a futures contract based on the DJIA on September 5, 1997, prior to the enactment of the CFMA. See letter from Jean A. Webb, Secretary, CFTC to Thomas R. Donovan, President & CEO, CBOT, dated September 5, 1997. Accordingly, pursuant to CEA Section 1a(25)(B)(ii) and Exchange Act Section 3(a)(55)(C)(ii), the DJIA is not a narrow-based security index.

¹⁸ SFE represents that it has previously agreed to co-operate with the CFTC in connection with prior requests for no-action relief and reconfirms that, consistent with those prior requests, it will cooperate with the CFTC with respect to trading in SFE's 1-Day Option on the CBOT Mini-Sized Dow Futures Contract. See letter from Mr. Starr to Mr. McCarty, dated December 14, 2005, at 3. The SFE confirms that the information sharing agreement that it entered into with the CFTC in conjunction with the relief SFE obtained pursuant to Commission Regulation 30.10 applies to data pertaining to SFE's 1-Day Option Contract on the CBOT Mini-Sized Dow Futures Contract. *Id.* at 4. The SFE also is a signatory to the International Information Sharing Memorandum of Understanding and Agreement signed on March 15, 1996, at Boca Raton, Florida.

SFE's regulator, the ASIC, is a signatory to the International Organization of Securities Commission's Multilateral Memorandum of Understanding Concerning Consultation and Cooperation and the Exchange of Information ("IOSCO MOU"). The IOSCO MOU, to which the CFTC is also a signatory, is a multilateral mechanism for sharing surveillance information on a bilateral basis between regulators. Prior to signing the IOSCO MOU, a

In light of the foregoing, this Office will not recommend any enforcement action to the Commission based on Sections 2(a)(1)(C)(iv), 4c(b), or 12(e) of the CEA, as amended, or Commission Rule 33.3(a), if SFE's 1-Day Option Contract on the CBOT Mini-Sized Dow Futures Contract 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 SFE 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 and options thereon based on non-narrow-based security indices.

SFE also has requested that, upon issuance of the relief granted herein, it be permitted to make its 1-Day Option Contract on the CBOT Mini-Sized Dow Futures Contract available for trading through the SYCOM electronic terminals of its U.S. members in accordance with the terms of the August 10, 1999 foreign terminals no-action letter ("August 10, 1999 letter") issued by Commission staff to SFE.¹⁹ In this regard, SFE has certified that it is in compliance with the terms of the August 10, 1999 letter and that SFE's 1-Day Option Contract will be traded in accordance with the terms and conditions of the August 10, 1999 letter.²⁰ 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 SFE to make its 1-Day Option 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 SFE in the August 10, 1999 letter extends to SFE's 1-Day Option Contract.

regulator must establish through a fair and transparent process that it has the legal capacity to fulfill its terms and conditions. The ASIC and the CFTC are also parties to a bilateral Memorandum of Understanding Concerning Consultation and Cooperation in the Administration and Enforcement of Futures Laws (October 19, 1994). In addition, the ASIC through its predecessor, the Australian Securities Commission, 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.

¹⁹ See CFTC Staff Letter No. 99-37 [1998-1999 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 27,757 (Aug. 10, 1999).

²⁰ See letter from Malcolm Starr, General Counsel & Secretary, SFE, to Duane Andreson, Special Counsel, CFTC, dated May 5, 2006.

The offer and sale in the U.S. of SFE's 1-Day Option Contract on the CBOT Mini-Sized Dow Futures Contract 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.²¹

Sincerely,

Nanette R. Everson
General Counsel

²¹ See 17 C.F.R. Part 30.