



U.S. COMMODITY FUTURES TRADING COMMISSION

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Division of
Market Oversight

CFTC letter No. 06-21
September 22, 2006
No-Action
Division of Market Oversight

Ms. Arul Ramiah
Head of Regulatory Policy
Singapore Exchange Limited
2 Shenton Way, #19-00
SGX Centre 1
Singapore 068804

Re: Request of Singapore Exchange Ltd for Modification of No-Action Relief from
(a) Contract Market Designation under Section 5 of the Commodity Exchange Act; and
(b) Extension of Such No-Action Relief to Registration as a Derivatives Transaction
Execution Facility under Section 5a of the Commodity Exchange Act

Dear Ms. Ramiah:

On December 17, 1999, the Division of Trading and Markets (T&M) of the Commodity Futures Trading Commission (Commission) issued a no-action letter¹ and confirmed that it would not recommend that the Commission institute enforcement action against the Singapore International Monetary Exchange Limited (SIMEX) or its members solely based upon SIMEX's failure to obtain contract market designation pursuant to Sections 5 and 5a of the Commodity Exchange Act (Act) if: (i) SIMEX members trade for their proprietary accounts through SIMEX's electronic trading and order matching system (SIMEX ETS) terminals in the United States; (ii) SIMEX members who are registered with the Commission as futures commission merchants (FCM) or who are exempt from such registration pursuant to Rule 30.10 (Rule 30.10 firms) submit orders from U.S. customers for transmission to SIMEX ETS; and/or (iii) SIMEX members who are registered with the Commission as FCMs or who are Rule 30.10 firms accept orders through automated order routing systems (AORS) from U.S. customers for submission to SIMEX ETS.

The SIMEX no-action letter summarized various representations made by SIMEX in its request for no-action relief, including representations concerning the structure of SIMEX, its products, its membership criteria, the architecture, operation and trading requirements of SIMEX

¹ CFTC Staff Letter No. 99-63 (December 17, 1999) (SIMEX no-action letter). On July 1, 2002, the Commission's staff was reorganized. Requests for no-action relief from the contract market designation requirement or derivatives transaction execution facility (DTEF) registration requirement are now reviewed by the Division of Market Oversight (DMO or the Division).

ETS, the activities conducted by its representative office in the U.S., the regulatory regimes governing SIMEX, its members, and SIMEX ETS, and the relevant information-sharing arrangements.

By letter dated August 11, 2006, you notified DMO of material changes that have occurred since the SIMEX no-action relief was granted and requested that the relief be modified to reflect additional circumstances and arrangements that were not applicable at the time that the SIMEX no-action letter was issued and that the no-action relief be extended to include non-registration as a DTEF under Section 5a of the Act.²

1. Existing No-action Relief. With respect to material developments since the no-action relief was granted to SIMEX, you represent that, among others, the following market and regulatory developments have taken place:³

A. **Demutualization & Reorganization.** The securities and futures exchanges in Singapore have demutualized. The Singapore Exchange Ltd (Exchange) was formed and has become a holding company for the Stock Exchange of Singapore (SES) and SIMEX. SIMEX was renamed Singapore Exchange Derivatives Trading Ltd (SGX) and now operates as a wholly owned subsidiary of the Exchange. Effective October 2, 2006, SGX expects to operate a wholly electronic futures exchange. No contracts are expected to be traded on the floor, which would be closed on September 29, 2006.

B. **Regulatory Regime.** Since 1999 when the no-action relief was granted, the regulatory landscape governing exchanges in Singapore has undergone various changes. The Singapore Futures Trading Act (FTA), under which SIMEX was an approved futures exchange, was repealed and the laws and regulations applicable to the Exchange and its subsidiaries, including SGX, were consolidated into the Securities and Futures Act (SFA). The SFA, which came into effect on October 1, 2002, introduced a single licensing framework to regulate the carrying out of one or more regulated activities in either the securities or futures market and also introduced a risk-based capital regime, which required member companies to maintain levels of capital corresponding more closely with the risks arising from the business activity which they undertake. Pursuant to July 1, 2005, amendments to the SFA, the Exchange was approved as an Approved Holding Company⁴ and SGX was approved as an Approved Exchange. As an Approved Exchange, SGX is required to, among other things, maintain a fair, orderly and transparent market and prohibit fraud, abuse and market manipulation in each market⁵ it

² The SIMEX no-action letter referred only to contract market designation because at that time there was no provision in the Act or rules thereunder governing a DTEF, a category of board of trade created by the Commodity Futures Modernization Act of 2000.

³ Many of these developments have already been highlighted to the Commission's Office of General Counsel in requests to permit the sale of foreign stock index contracts traded on SGX and the offer of such products in the U.S. by futures brokerage firms located in Singapore.

⁴ An Approved Holding Company is one that owns either any approved exchanges or designated clearing houses. The Exchange owns and operates two approved exchanges and two designated clearing houses – each corresponding to the securities and the futures markets respectively.

⁵ SGX will operate two markets under its authority as an Approved Exchange. The first market, SGX-DT, is dedicated to financial futures and options; the second market, JADE, described below, will be dedicated to commodity futures and is the offspring of a joint venture between SGX and CBOT Holdings Inc.

operates.⁶ The Exchange and its subsidiaries are regulated by the Monetary Authority of Singapore (MAS) under the SFA.⁷

C. Revised Rules. In line with its conversion to a wholly electronic exchange, SGX, after public consultation and regulatory clearance from MAS, has completed a major revision of its Derivatives Trading Rulebook, now renamed the Futures Trading Rulebook, which addresses market and regulatory developments and is more specifically tailored to a screen-based and cross-border trading environment. Among other things, the revised rulebook (i) codifies the requirement that directors, chief executives and key personnel of a member are fit and proper;⁸ (ii) consolidates and streamlines the membership categories for individuals and firms into two main categories – clearing members and trading members; (iii) prohibits members from co-mingling or depositing the member's own money and assets into their customers' accounts; (iv) requires members to report all breaches of laws, rules or regulations, whether they occur in Singapore or overseas; and (v) clarifies the standard of proof in proceedings before the Disciplinary and Appeals Committees. SGX represents that to the extent that the prior rulebook contained certain fundamental market integrity rules relating to anti-manipulation and prudential measures, these are equally relevant in an electronic environment and will continue to be observed.

D. Trading Engine for SGX-DT Market. In August 2004 SGX, launched a new trading engine for the trading of derivatives, SGX Quotation and Execution System (SGX QUEST). SGX QUEST replaced the prior derivatives trading engine, SGX ETS, known as SIMEX ETS when the no-action relief was granted. SGX QUEST is the trading platform for SGX-DT, the market for SGX financial futures and options on futures contracts, and is based on the software, CLICK XT™, developed by OMX.

Order placement, modification and cancellation are managed within the Central Trading System, which also stores stop limit orders and only places them in the order book when certain

⁶ The SFA has also been strengthened on other fronts and SGX is now subject to more stringent corporate governance and other requirements. For example, (i) rule-making and rule amendments by SGX are subject to a statutorily controlled process which incorporates public consultations; (ii) SGX's key management is subject to certain fit and proper guidelines relating to character, honesty and integrity; (iii) SGX is subject to a more extensive financial reporting framework; and (iv) SGX is subject to mandatory corporate governance regulations which include heightened independence requirements for its independent directors serving on its board.

⁷ SIMEX was regulated by MAS at the time it was granted the no-action relief. The Division notes that the Commission had previously reviewed the regulatory regime administered and enforced by MAS in connection with relief it granted to SIMEX in 1989. On January 10, 1989, the Commission issued an order pursuant to Rule 30.10 that granted exemptive relief to SIMEX members that allowed them to solicit and accept orders from U.S. customers for otherwise permitted transactions on SIMEX. 54 Fed. Reg. 806 (January 10, 1989). In the order, the Commission noted that the standards for relief set forth in Rule 30.10 generally had been satisfied by SIMEX and compliance by the Rule 30.10 Firms with applicable Singapore law and SIMEX Rules could be substituted for compliance with certain provisions of the Act and the Commission's rules set forth in the order. Further, on September 16, 1999, the Commission issued an order pursuant to Rule 30.10 that granted exemptive relief to SIMEX members that allowed them to solicit and accept orders from U.S. customers for otherwise permitted transactions on Eurex Deutschland. 64 Fed. Reg. 50248 (September 16, 1999).

⁸ SGX represents that it would look to the Guidelines on Fit and Proper Criteria issued by MAS in July 2005 when determining whether an officer is fit and proper.

trigger conditions are met. Information including best bid/offer, last execution price, and market and price depth is broadcast real-time when there are changes to the order book. All orders are queued and matched in accordance with price-time priority, although price point and pro-rata matching algorithms are also used for some products.⁹ When orders are matched, trade information is provided to the parties and transmitted real-time to SGX's clearing system, discussed below.

SGX represents that it will not permit terminals or AORSs located in the U.S. to be used to trade any SGX financial futures contract or option thereon listed on SGX QUEST on any broad-based securities index, non-U.S. government debt security, individual stock or narrow-based securities index for which SGX has not received the necessary no-action relief or approval from the Commission or the U.S. Securities and Exchange Commission, as applicable.

E. Market Surveillance. In July 2005, SGX decided to upgrade to a more sophisticated market and trade practice surveillance system known as Securities Market Automated Research Trading and Surveillance (SMARTS)¹⁰. SMARTS integrates trading and other data sources and triggers alerts in the event of unusual trading activity. SMARTS is customized for use in the electronic markets, allows for real-time monitoring, and is designed to handle and process large volumes of order and trade data from SGX QUEST. In addition, it allows for the construction of trends and allows the SGX surveillance team to isolate the activities of a particular trader and replay his market activities. This feature allows for the detection of potential attempts to manipulate the market and potential trade practice violations. SGX QUEST audit trails capture trade data, order data, participant data and time and sales information, which are then fed into SMARTS for real-time monitoring and surveillance purposes. Audit trail logs are archived daily and maintained for seven years.

F. Clearing. Singapore Exchange Derivatives Clearing Limited (SGX-DC), formerly referred to as the SIMEX Clearing House, clears all futures and options on futures contracts traded on SGX. SGX-DC is a wholly-owned subsidiary of the Exchange and is regulated by MAS as a Designated Clearing House under the SFA. SGX-DC's clearing procedures are substantially the same as those in existence when SIMEX was granted the no-action relief. As before, SGX-DC is substituted as the central counterparty on all cleared futures and options on futures transactions; it requires clearing members to maintain separate accounts for house and customer positions; it margins positions on a gross (not a net) basis (using SPAN methodology); and it applies daily mark-to-market to all open positions. It also has standardized procedures to address the default of a clearing member. Since the granting of the no-action relief, SGX-DC has expanded its services to provide clearing for over-the-counter derivatives contracts.

⁹ Under the price point maker allocation algorithm, orders which are the first to improve the prevailing bid/ask prices, known as orders with price point maker status, would receive priority over other orders at the same price. With the pro-rata order and matching allocation algorithm, orders entered at the same price would be matched based on the orders' volume contribution to the aggregate volume of all resting orders at that price.

¹⁰ SMARTS is a proprietary system developed by an Australian vendor and is also currently deployed by the Australian Stock Exchange, Helsinki Stock Exchange and Stock Exchange of Hong Kong. SMARTS has been successfully implemented in the securities market operated by the Exchange since the end of 2000.

G. **Contracts.** In addition to the contracts currently available for trading on SGX QUEST pursuant to the SIMEX no-action letter, you request, by letter dated September 15, 2006, to list for trading on SGX QUEST three index contracts for which SGX has previously received no-action relief from the Commission's Office of General Counsel allowing the contracts to be offered and sold in the U.S.: the MSCI Singapore Free Stock Index futures contract,¹¹ the MSCI Japan Index futures contract,¹² and the S&P CNX Nifty Index futures contract.¹³

H. **Presence in the U.S.:** SGX closed its U.S. office in June 2003 and no longer maintains an office or any staff in the U.S. SGX, however, does engage in general marketing activities in the U.S., including participation in industry conferences and expositions in the U.S. SGX does not, and represents that it will not, provide any investment advice to U.S. persons whatsoever or solicit, accept or direct trading of orders in the U.S. with respect to products traded on SGX.

2. **JADE.** In your letter dated August 11, 2006, you also request that the no-action relief be amended to include the Joint Asian Derivatives Exchange (JADE), a joint venture of SGX and CBOT Holdings Inc., the parent of the Chicago Board of Trade (CBOT).

A. **Overview.** The JADE market is an electronic derivatives market for futures and options on futures contracts on physical commodities based in Asia and is operated as a division of SGX under its authority as an Approved Exchange in Singapore. SGX intends to provide access to JADE market contracts through terminals and AORS located in Asia, the U.S. and other geographic regions, and expects most of the trading volume will originate in Asia. The products listed on the JADE market would be made available for trading on the CBOT's electronic trading and order matching system known as the e-cbot trading platform powered by LIFFE CONNECT (e-cbot System). The material changes previously discussed with respect to SGX QUEST are generally applicable to trading on the JADE market, with the following major exceptions.

B. **Trading System.** As stated above, JADE market products would be traded on the e-cbot System and not on SGX QUEST. Although DMO has not performed an independent assessment of the security or soundness of the e-cbot System for trading JADE futures and options on futures, it should be noted that that e-cbot System is virtually identical to the NASDAQ LIFFE electronic trading platform, using LIFFE CONNECT, and that NASDAQ LIFFE was previously designated as a contract market by the Commission.¹⁴ Furthermore, Commission staff undertook a thorough review of the e-cbot System in connection with the CBOT's October 31, 2003, self-certification to the Commission of a set of rule changes to

¹¹ CFTC Staff Letter No. 00-77, June 21, 2000.

¹² CFTC Staff Letter No. 03-07, February 13, 2003.

¹³ CFTC Staff Letter No. 04-02, January 7, 2004.

¹⁴ The Commission approved NASDAQ LIFFE, LLC, a joint venture of the NASDAQ Stock Market and the London International Financial Futures Exchange (LIFFE) as a designated contract market (DCM) on August 22, 2001. On July 24, 2003, NASDAQ LIFFE ended its relationship with NASDAQ and the Exchange was renamed NQLX.

replace its a/c/e electronic trading system with the e-cbot electronic trading system using LIFFE CONNECT. The e-cbot System is also used at the Winnipeg Commodity Exchange, which recently received foreign terminal no-action relief from DMO.¹⁵

The trading algorithm used for trading on the JADE market is an order level pro-rata algorithm with priority order, a minimum volume requirement, and a maximum volume cap. With this algorithm, a priority flag is given to the order that was the first to enter the market at the best price if that order is above a certain volume (the “minimum volume”). When this priority flag is assigned, the order will gain all incoming volume up to a certain maximum volume (the “volume cap”). When this volume cap is reached, all remaining volume is divided pro-rata among this order and the other orders at the best price.

SGX represents that it believes that the CBOT’s oversight of the e-cbot System adheres to the principles expressed in the Principles for the Oversight of Screen-Based Trading Systems for Derivative Products published in 1990 by the International Organization of Securities Commissions (IOSCO Principles). Further, SGX represents that it will comply with the IOSCO Principles in its operation of the e-cbot System.

C. Market Surveillance. The SMARTS system would not be used for the real-time surveillance of the JADE market. Instead, SGX has contractually agreed to adopt the market and control tools of CBOT to conduct real-time surveillance for the JADE market. Audit trail data from the e-cbot System would be sent to SMARTS to generate exception reports for after-market surveillance by SGX. CBOT has undertaken to provide audit trail data captured by the e-cbot System relating to trade data, order data, participant data and time and sales information to the SGX surveillance department. The SGX surveillance officers would also have access to the LIFFE CONNECT Monitor and Control Tools, which provide a near real-time view into JADE market activity.

D. Clearing. SGX-DC will apply the same basic procedures to clearing JADE market futures and options on futures contracts that it does for the SGX-DT market, subject to certain rule amendments and additional procedures that are specific to the clearing of physical-delivery contracts listed on the JADE market.

E. Contracts. In the JADE market, SGX intends to list futures and options on futures contracts of physical commodities of Asian origin. Thus, SGX rules addressing physical delivery apply only to JADE physical delivery contracts. The first contract to be launched on JADE is a physically delivered TSR 20 Rubber Futures Contract.

F. Miscellaneous. Separate error trade policies and dispute resolution rules will apply to contracts traded on the JADE market.

¹⁵ CFTC Staff Letter No. 04-35, December 15, 2004.

3. Request for Amendment of No-action Relief

You have requested that the SIMEX no-action relief be modified to reflect additional circumstances and arrangements that were not applicable at the time that the SIMEX no-action letter was issued and that the no-action relief be extended to include failure to register as a DTEF under Section 5a of the Act. Further, you have requested that DMO amend the no-action relief to permit SGX to make its two electronic trading and order matching systems available to SGX members in the U.S. without registering with the Commission as a DCM or a DTEF pursuant to Sections 5 and 5a of the Act, or comply with those Commission regulations that specifically relate to DCMs or DTEFs, in connection with the installation and use in the U.S. of terminals and/or AORSs that are used to submit orders to SGX.

Specifically, you request that the Division amend the no-action relief to:

A. Permit SGX to make (i) the e-cbot System available to U.S.-based participants to trade JADE market futures and options on futures contracts and (ii) SGX QUEST available to U.S.-based participants to trade SGX futures and options on futures contracts without in either case having to register with the Commission either as a DCM under Section 5 of the Act or as a DTEF under Section 5a of the Act or comply with Commission regulations that specifically relate to DCMs or DTEFs in connection with the installation and use in the U.S. of terminals providing direct access to SGX's trading and order matching systems and/or AORS that are used to submit orders to SGX; and

B. Permit (i) SGX members to use terminals or AORSs located in the U.S. giving them access to the e-cbot System to trade JADE market futures and options on futures contracts on SGX for their proprietary accounts; (ii) SGX members who are registered with the Commission as FCMs to use terminals or AORSs located in the U.S. giving them access to the e-cbot System to submit and transmit orders from U.S. customers to trade JADE market contracts on SGX; and (iii) SGX members who are registered as FCMs or who are Rule 30.10 firms to accept orders through AORS from U.S. customers submitted to the e-cbot System to trade JADE market contracts on SGX; and

C. Permit (i) SGX members to use terminals or AORSs located in the U.S. giving them access to SGX QUEST to trade financial futures and options on futures contracts on SGX for their proprietary accounts; (ii) SGX members who are registered with the Commission as FCMs to use terminals or AORSs located in the U.S. giving them access to SGX QUEST to submit and transmit orders from U.S. customers to trade such contracts on SGX; and (iii) SGX members who are registered as FCMs or who are Rule 30.10 firms to accept orders through AORSs from U.S. customers submitted to SGX QUEST to trade such contracts on SGX.

4. Conclusion

DMO has reviewed the requested amendment and supporting documentation and the earlier no-action letter and has determined that granting the amendment should not have a significant impact on the no-action relief as granted and would not be contrary to public policy. Accordingly, DMO confirms that it will not recommend that the Commission institute

enforcement action against SGX or its members solely based upon SGX's failure to obtain contract market designation or DTEF registration pursuant to Section 5 or 5a, respectively, of the Act, or to comply with those Commission regulations that specifically relate to DCMs or DTEFs, if: (i) SGX members located in the U.S. trade futures and options on futures contracts for their proprietary accounts on SGX-DT or the JADE market through SGX QUEST or the e-cbot System; (ii) SGX members who are registered with the Commission as FCMs submit orders by or on behalf of U.S. customers to SGX-DT or the JADE market through SGX QUEST or the e-cbot System; and (iii) SGX members who are registered with the Commission as FCMs or who are Rule 30.10 Firms accept orders from U.S. customers transmitted via AORS for submission to SGX-DT or the JADE market through SGX QUEST or the e-cbot System.

This Division's no-action position is applicable only to the futures and option contracts previously identified in the SIMEX no-action letter (for SGX-DT), the three index contracts for which, subsequent to the date of the SIMEX no-action letter, SGX received no-action relief from the Commission's Office of General Counsel allowing the contracts to be offered and sold in the U.S. (SGX-DT), and to the physically delivered TSR 20 Rubber Futures Contract (the JADE market). If additional futures and options on futures contracts become available for trading through SGX QUEST or the e-cbot System, SGX may make such futures and options on futures contracts available for trading through its trading systems from the U.S. in accordance with the provisions of the Commission's Notice of Revision of Commission Policy Regarding the Listing of New Futures and Option Contracts by Foreign Boards of Trade that have Received Staff No-Action Relief to Provide Direct Access to their Automated Trading Systems from Locations in the United States.¹⁶

The Division notes that its no-action position does not relieve SGX from compliance with the terms and conditions set forth in the SIMEX no-action letter.¹⁷ As with all no-action letters, DMO retains the authority to condition further, modify, suspend, terminate, or otherwise restrict the terms of the no-action relief provided herein, in its discretion. This amendment to the Division's no-action position applies only to the additional circumstances and arrangements identified in your letter of August 11, 2006, and discussed herein, and should not be construed to express any opinion as to the effect of any other change in circumstances that may have occurred or may occur in the future.

The no-action position taken herein is taken by the Division only and does not necessarily reflect the views of the Commission or any other unit or member of the Commission's staff. It is based upon the information and representations contained in SGX's request for modification and extension of the no-action relief. Any materially different, changed, or omitted facts or circumstances may render this letter void.

¹⁶ 71 Fed. Reg. 19877 (April 18, 2006); corrected at 71 Fed. Reg. 21003 (April 24, 2006).

¹⁷ Among those conditions are requirements that SGX continue to adhere to the IOSCO Principles and that satisfactory information-sharing arrangements between the Commission and MAS remain in effect.

Ms. Arul Ramiah
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If you have any questions regarding this correspondence, please contact Duane C. Andresen, Special Counsel, Division of Market Oversight, at (202) 418-5492.

Very truly yours,

Richard A. Shilts
Director

cc Gregory C. Prusik, Vice-President, Registration, NFA
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