



## U.S. COMMODITY FUTURES TRADING COMMISSION

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Office of General Counsel

CFTC Letter No. 09-47

No-Action

November 9, 2009

Office of General Counsel

Kenneth M. Raisler, Esq.  
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125 Broad Street  
New York, NY 10004-2498

Re: Tokyo Stock Exchange's Request for No-Action Relief in Connection with the Offer and Sale in the United States of its Mini Futures Contract Based on the TOPIX and its Futures Contracts Based on the TOPIX Core30 Index and TSE REIT Index

Dear Mr. Raisler:

This is in response to your letters, attachments, facsimiles and electronic mail dated from December 10, 2007 to January 14, 2009, requesting on behalf of the Tokyo Stock Exchange ("TSE"), 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 of TSE's mini futures contract based on the Tokyo Stock Price Index ("TOPIX") and its futures contracts based on the TOPIX Core30 Index ("TOPIX Core30") and the TSE REIT Index ("TSE REIT").

We understand the facts to be as follows. The TSE is a licensed stock exchange under Japanese law and is authorized to trade stocks, bonds, fixed income derivative products, and various other types of derivative products, including equity derivative products.<sup>1</sup> Pursuant to a reorganization that became effective on November 1, 2007, TSE Regulation, a wholly-owned subsidiary of TSE Group, Inc. and an affiliate of TSE, acts as the self-regulatory organization with respect to all of TSE's markets and products, acting in part through TSE Regulation's

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<sup>1</sup> This Office previously issued no-action relief to the TSE with respect to its standard-sized contract on the TOPIX, *see CFTC Staff Letter No. 92-2 [1990-1992 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 25,210* (Jan. 16, 1992), and with respect to its futures contract on the S&P/TOPIX 150 Index, *see CFTC Staff Letter No. 01-45 [2000-2002 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 28,555* (May 23, 2001).

Market Surveillance Department, which monitors and investigates trading on the TSE and assists in bringing actions against those found to have violated applicable rules.<sup>2</sup>

The TSE is operated pursuant to, and is governed by, the Japanese Securities and Exchange Law and is regulated by the Japanese Financial Services Agency (“FSA”). Pursuant to changes in law that were approved by the Japanese Diet and that became effective on September 30, 2007, the Securities and Exchange Law has been replaced by the Financial Instruments and Exchange Law, a more comprehensive statute that, among other things, expands the regulatory scope of the law and the jurisdiction of the FSA to cover a broader range of markets and products and expands the prohibitions and penalties for various types of trading abuses, including manipulation. Under both prior law and the new statutory changes, the FSA possesses broad supervisory responsibility for all aspects of financial services, including inspection, supervision, and surveillance of financial activities.<sup>3</sup>

The TOPIX is a broad-based, free-float-adjusted-market-capitalization-weighted index of all the common stocks and Real Estate Investment Trusts (“REITs”) included in the First Section of the TSE. The TOPIX Core30 is a broad-based, free-float-adjusted-market-capitalization-weighted index composed of 30 of the largest companies included in the TOPIX. The TSE REIT is a broad-based, free-float-adjusted-market-capitalization-weighted index comprised of the equity securities of all REITs listed on the TSE.<sup>4</sup> All of the indices are managed, calculated and published by the TSE.<sup>5</sup> Based on data supplied by TSE, the total adjusted market capitalization

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<sup>2</sup> See letter from Kenneth M. Raisler, Esq., Sullivan & Cromwell LLP, to Terry S. Arbit, General Counsel, CFTC, dated June 10, 2008, at 2.

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

<sup>4</sup> REITs are pools of investment capital gathered by investment corporations or fund managers and invested in real estate property. In November 2000, the Japanese Investment Trust and Investment Corporation Law was amended to include real estate under the types of capital allowed for use by investment trusts, which facilitated the development and listing of REITs. In March 2001, TSE created listing rules for REITs to be traded on its market and the first REITs began trading on the TSE in September 2001. *Id.* at 5.

<sup>5</sup> The TOPIX is not subject to periodic reviews. It always contains the stocks included in the First Section of the TSE, which includes the stocks of the largest and most well-capitalized companies listed and traded on the TSE. Thus, the constituent makeup of the TOPIX changes when stocks are listed and delisted on the TSE First Section. Similarly, the TSE REIT is not subject to periodic reviews; it always contains the REITs listed for trading on TSE. For both the TOPIX and TSE REIT, adjustments are made to the base market value of the relevant index to maintain index continuity. The TOPIX Core30 is subject to biannual reviews in January and July, with possible additions and deletions considered in January and additions only considered in July. Announcements of constituent changes are published on the first business day of January or July and are effective one business day before the last business day of the relevant month. At each January review, the TSE first determines the top 90 stocks in the First Section by total trading value during the previous three-year period and ranks those stocks by free-float market capitalization. The 15 largest stocks on that list of 90 stocks are selected for inclusion. The remaining 15 component stocks are the 15 largest stocks that are on the list of 90 stocks and

of the securities in the TOPIX was approximately US\$ 2.39 trillion, in the TOPIX Core30 was approximately US\$ 897.67 billion, and in the TSE REIT was approximately US \$36.03 billion as of March 17, 2008.<sup>6</sup> The largest single security by weight represented 4.38%, and the five largest securities by weight represented 12.83%, of the TOPIX.<sup>7</sup> The largest single security by weight represented 11.65%, and the five largest securities represented 34.16%, of the TOPIX Core30.<sup>8</sup> The largest single security by weight represented 16.15%, and the five largest securities represented 43.45% of the TSE REIT.<sup>9</sup> The securities comprising the lowest 25% of the TOPIX and TOPIX Core30 had aggregate values of average daily trading volume in excess of US\$ 30 million: about US\$ 8.76 billion and US\$ 2.71 billion, respectively, over the six-month period ending February 29, 2008.<sup>10</sup> The securities comprising the lowest 25% of the TSE REIT had an aggregate value of average daily trading volume of about US\$ 47 million for the six-month period ending October 31, 2008.<sup>11</sup> All three indices are calculated in real time and disseminated by electronic means through major data vendors.<sup>12</sup>

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that are current TOPIX Core30 constituents. Those stocks must be ranked within the top 40 stocks by adjusted free-float market capitalization on the “base date,” which is the third Friday of the previous December for the January review and the third Friday of the previous June for the July review. If 30 stocks do not meet these criteria, then the additional stocks are selected from the list of 90 stocks by trading value until the TOPIX Core30 has 30 stocks. *See Tokyo Stock Exchange Index Guidebook* (February 2008 version). Additions and deletions may occur to the TOPIX Core 30 outside the periodic review due to certain events including delistings, mergers and spin-offs. *Id.* Changes to the TOPIX, the TSE REIT and TOPIX Core30 methodologies must be approved by TSE’s Committee of Executive Officers. The Committee members, as well as all other TSE personnel who have access to index information, are subject to the TSE’s internal guidelines, which prohibit disclosure of the information and prohibit trading by officers or employees in TSE futures contracts or the underlying securities. *See* electronic mail from David Gilberg, Esq., Sullivan & Cromwell LLP, to Julian E. Hammar, Assistant General Counsel, CFTC, dated May 26, 2008.

<sup>6</sup> *See* letter from Mr. Raisler to Mr. Arbit, dated June 10, 2008, at Appendix A.

<sup>7</sup> *Id.* at 3 and Appendix A.

<sup>8</sup> *Id.* at 4 and Appendix A.

<sup>9</sup> *Id.* at 5 and Appendix A.

<sup>10</sup> *Id.* at 3-4 and Appendix A.

<sup>11</sup> *See* electronic mail from David Gilberg, Esq., Sullivan & Cromwell LLP, to Julian E. Hammar, Assistant General Counsel, CFTC, dated November 25, 2008.

<sup>12</sup> *See* letter from Mr. Raisler to Mr. Arbit, dated June 10, 2008, at 3, and *Tokyo Stock Exchange Index Guidebook*, at 24 (February 2008 version).

TSE's mini futures contract on the TOPIX and its futures contracts on the TOPIX Core30 and TSE REIT provide for cash settlement. For all three contracts, prices are quoted in index points with each index point equal to 1,000 Japanese yen per contract. The minimum price fluctuation is 0.25 index point for the mini futures contract on the TOPIX and 0.5 index point for the futures contracts on the TOPIX Core30 and TSE REIT. TSE currently lists for trading the nearest three months of the March quarterly cycle. The last trading day for the contracts is the last business day prior to the second Friday of the contract month. The final settlement price for each contract is based on a special opening quotation for the relevant index using the opening prices of the constituent stocks (or REIT shares in the case of the TSE REIT) on the second business day following the last trading day.<sup>13</sup>

The Commodity Exchange Act ("CEA"),<sup>14</sup> as amended by the Commodity Futures Modernization Act of 2000 ("CFMA"),<sup>15</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>16</sup> with the exception of security futures products,<sup>17</sup> over which the Commission shares jurisdiction with the Securities and Exchange Commission ("SEC").<sup>18</sup> Thus, the Commission's jurisdiction remains exclusive with regard to a futures contract on a group or index of securities that is broad-based pursuant to CEA Section 1a(25).<sup>19</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>20</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 the trading of futures contracts on a group

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<sup>13</sup> *Id.* at 3-5 and Appendix B (Contract Specifications).

<sup>14</sup> 7 U.S.C. § 1 *et seq.*

<sup>15</sup> Appendix E of Pub. L. No. 106-554, 114 Stat. 2763 (2000).

<sup>16</sup> See CEA Section 2(a)(1)(C)(ii).

<sup>17</sup> A security futures product is 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>18</sup> See CEA Section 2(a)(1)(D).

<sup>19</sup> See CEA Section 2(a)(1)(C)(ii).

<sup>20</sup> CEA Section 2(a)(1)(D) governs the offer and sale of security futures products.

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>21</sup>

While Section 2(a)(1)(C)(ii) provides that no contract market 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>22</sup>

Accordingly, Commission staff has examined the TOPIX and TSE’s mini futures contract based thereon, and the TOPIX Core30, TSE REIT and TSE’s futures contracts based thereon, to determine whether the TOPIX, the TOPIX Core30, the TSE REIT and the TSE’s respective

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<sup>21</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>22</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.

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 letter, attachments, facsimiles and electronic mail cited above, we have determined that the TOPIX and TSE's mini futures contract based thereon, and the TOPIX Core30, TSE REIT and TSE's respective futures contracts based thereon, conform to these requirements.<sup>23</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. As noted above, all of the securities underlying the TOPIX, the TOPIX Core30 and the TSE REIT are traded on the TSE. Accordingly, TSE should have access to information with respect to the securities underlying the TOPIX, TOPIX Core30 and TSE REIT necessary to detect and deter manipulation. In the event that TSE 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>24</sup>

In light of the foregoing, this Office will not recommend enforcement action to the Commission based on Sections 2(a)(1)(C)(iv), 4(a), or 12(e) of the CEA, as amended, if TSE's mini futures contract based on the TOPIX and its futures contracts based on the TOPIX Core30 and TSE REIT 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 TSE with all regulatory requirements imposed by the FSA, and the applicable laws and regulations of Japan. 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.

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<sup>23</sup> In making this determination, Commission staff has concluded that the TOPIX, the TOPIX Core30 and the TSE REIT do not have any of the elements of a narrow-based security index as enumerated in CEA Section 1a(25)(A). Accordingly, the TOPIX, the TOPIX Core30 and the TSE REIT would not be narrow-based security indices if traded on a designated contract market or DTEF.

<sup>24</sup> TSE represents that it is able to obtain and provide any necessary information regarding the TOPIX, the TOPIX Core30, the TSE REIT, their underlying securities, and TSE's respective futures contracts based thereon, and undertakes to cooperate with Commission requests for information. *See* letter from Mr. Raisler to Mr. Arbit, dated June 10, 2008 (attachment). TSE is an affiliate member of the Intermarket Surveillance Group ("ISG"), which consists of representatives from securities and futures exchanges in the U.S. and other countries. The members of ISG have agreed to share information to ensure coordinated surveillance of intermarket trading abuses. TSE also is a signatory to the International Information Sharing Memorandum of Understanding signed on March 15, 1996, at Boca Raton, Florida. *Id.* In addition, TSE's regulator, the FSA, signed a Statement of Intent Concerning Cooperation, Consultation and the Exchange of Information ("SOI") with the Commission and the Securities and Exchange Commission, on May 17, 2002 (as amended January 2006).

The offer and sale in the U.S. of TSE's mini futures contract on the TOPIX and its futures contracts on the TOPIX Core30 and TSE REIT 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,

Dan M. Berkovitz  
General Counsel

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