



## U.S. COMMODITY FUTURES TRADING COMMISSION

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Office of General Counsel

CFTC Letter No. 09-48

No-Action

December 23, 2009

Office of General Counsel

Ms. Janice Kan  
Vice President  
Head, Product Development  
Development Group  
Singapore Exchange, Ltd.  
2 Shenton Way, #19-00, SGX Centre 1  
Singapore 068804

Re: Singapore Exchange Derivatives Trading Limited'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 Nikkei 225 Stock Index

Dear Ms. Kan:

This is in response to your letter dated June 3, 2008, requesting on behalf of the Singapore Exchange Derivatives Trading Limited ("SGX-DT"), 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 SGX-DT's mini futures contract based on the Nikkei 225 Stock Index ("Nikkei 225" or "Index").

The Nikkei 225 is a broad-based, price-weighted composite security index (the unit is yen) made up of highly capitalized and actively traded stocks currently listed in the first section of the Tokyo Stock Exchange. As a widely recognized index of stock market activity in Japan, the Nikkei 225 is similar to the Dow Jones Industrial Average in the U.S.

This Office previously issued no-action relief with regard to SGX-DT's cash settled U.S. dollar denominated version of the Nikkei 225 futures contract in 2007 and the Japanese yen denominated version of the Nikkei 225 in 1986.<sup>1</sup> We also issued no-action relief with regard to the Osaka Securities Exchange's ("OSE") mini futures contract based on the Nikkei 225 in

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<sup>1</sup> See CFTC Staff Letter No. 07-07, [2005-2007 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 30,533 (May 24, 2007) and CFTC Staff Letter No. 86-6, [1986-1987 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 23,395 (December 5, 1986).

2006.<sup>2</sup> The subject mini Nikkei 225 futures contract is similar to the SGX-DT's standard Nikkei 225 futures contract and the OSE's Nikkei 225 mini futures contract for which we granted no-action relief in 1986 and 2006, respectively. As we understand the facts presented in your June 3, 2008 letter, the only significant differences are the contract size, minimum tick, and contract months. In that regard, the mini Nikkei 225 futures contract has a smaller contract multiplier of 100 Japanese yen, which is one-fifth of the standard SGX-DT contract, a minimum tick of 1 index point (100 Japanese yen per contract), which is smaller than the minimum tick of 5 index points (2,500 Japanese yen per contract) for the standard SGX-DT futures contract. The SGX-DT also lists the four March-quarterly-cycle months rather than the three nearest serial months and five nearest March-quarterly-cycle-months for the standard SGX-DT contract.<sup>3</sup>

The Commodity Exchange Act ("CEA" or "Act"),<sup>4</sup> as amended by the Commodity Futures Modernization Act of 2000 ("CFMA"),<sup>5</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>6</sup> with the exception of security futures products,<sup>7</sup> over which the Commission shares jurisdiction with the Securities and Exchange Commission ("SEC").<sup>8</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>9</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

<sup>2</sup> See CFTC Staff Letter No. 06-14, [2005-2007 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 30,267 (July 10, 2006).

<sup>3</sup> See letter from Janice Kan, Vice President, SGX-DT to Terry Arbit, General Counsel, CFTC, dated June 3, 2008.

<sup>4</sup> 7 U.S.C. § 1 *et seq.*

<sup>5</sup> Appendix E of Pub. L. No. 106-554, 114 Stat. 2763 (2000).

<sup>6</sup> See CEA Section 2(a)(1)(C)(ii).

<sup>7</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>8</sup> See CEA Section 2(a)(1)(D).

<sup>9</sup> See CEA Section 2(a)(1)(C)(ii).

2(a)(1)(C)(ii) or CEA Section 2(a)(1)(D).<sup>10</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 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>11</sup>

While Section 2(a)(1)(C)(ii) provides that no designated 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>12</sup>

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<sup>10</sup> CEA Section 2(a)(1)(D) governs the offer and sale of security futures products.

<sup>11</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) 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>12</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 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.

Previously, this Office examined the Nikkei 225 and concluded that the Nikkei 225 was not a narrow-based security index, as defined in Section 1a(25)(A) of the CEA.<sup>13</sup> This Office also has concluded in applying the criteria set forth in Section 2(a)(1)(C)(ii) of the CEA, that the Index was not readily susceptible to manipulation, nor to being used to manipulate any underlying security.<sup>14</sup> We continue to believe that this is the case. In this regard, as of October 20, 2009, the total market capitalization of the Index is very large, about 200 trillion Japanese yen (2.2 trillion U.S. dollars). (Source: Bloomberg Professional Service).<sup>15</sup> Moreover, no single stock or small group of stocks dominates the Index. Specifically, as of October 20, 2009, the largest stock in the Index represented 6.14% of the Index, and the five largest stocks represented 17.22% of the Index. Also, over the six-month period ending October 20, 2009, 219 of the 225 stocks (95.9% of the Index) had an average daily trading volume of at least 30,000 shares and 225 of 225 (100% of the Index) had a value of the average daily volume of at least \$1.5 million. In addition, we do not believe that the differences in contract terms between SGX-DT's standardized Nikkei 225 futures contract, which this Office previously concluded was not readily susceptible to manipulation, and SGX-DT's mini Nikkei 225 futures contract, would render the mini futures contract readily susceptible to manipulation within the meaning of the Act.

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 SGX-DT's mini futures contract based on the Nikkei 225 is offered or sold in the U.S. Because this position is based upon facts and representations contained in the letters 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 SGX-DT with all regulatory requirements imposed by the Monetary Authority of Singapore, and the applicable laws and regulations of Singapore. 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>13</sup> See CFTC Staff Letter No. 06-14, [2005-2007 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 30,267 (July 10, 2006). In addition, Section 1a(25)(B) of the Act specifies certain exclusions from the definition of a narrow-based security index. Among those exclusions is any index where the Commission had approved a U.S. futures contract on the index prior to the enactment of the CFMA on December 21, 2000. See CEA Section 1a(25)(B)(ii). On November 22, 1988, the Commission approved the Chicago Mercantile Exchange's Nikkei Stock Average futures contract, which is based on the same underlying index.

<sup>14</sup> *Id.*

<sup>15</sup> The daily noon buying rate on October 20, 2009 was 90.73 Japanese yen per U.S. Dollar.

The offer and sale in the U.S. of SGX-DT's mini futures contract on the Nikkei 225 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>16</sup>

Sincerely,

Dan M. Berkovitz  
General Counsel

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<sup>16</sup> See 17 C.F.R. Part 30.