



U.S. COMMODITY FUTURES TRADING COMMISSION

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Office of General Counsel

CFTC Letter No. 09-43
No-Action
August 26, 2009
Office of General Counsel

Paul M. Architzel, Esq.
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The Atlantic Building
950 F Street, NW
Washington, DC 20004-1404

Re: No-action Relief Request of BM&F Bovespa S.A. - Bolsa de Valores, Mercadorias e Futuros, in Connection with the Offer and Sale in the United States of its Futures Contracts Based on the Ibovespa Index

Dear Mr. Architzel:

This is in response to your letters, attachments, facsimiles and electronic mail dated from March 6, 2008 to May 5, 2009, requesting on behalf of BM&F Bovespa S.A. - Bolsa de Valores, Mercadorias e Futuros ("BM&F Bovespa"), 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 BM&F Bovespa's full-sized and mini-sized ("MINI") futures contracts based on the Ibovespa Index ("Ibovespa" or "Index").

We understand the facts to be as follows. BM&F Bovespa was created in 2008 as the result of the merger between the Brazilian Mercantile and Futures Exchange ("BM&F") and the São Paulo Stock Exchange ("BOVESPA").¹ BM&F was the futures exchange in Brazil, listing for trading futures contracts on equity indices and other commodities. BOVESPA was the cash equities exchange in Brazil. The two exchanges demutualized in 2007, and became known as BM&F S.A. and Bovespa Holding S.A., respectively. On May 8, 2008, the shareholders of both exchanges approved the integration of the two exchanges under a new company, BM&F Bovespa, which has been completed. The self-regulatory functions of the two exchanges, including the market surveillance function, have been unified under the merger.²

¹ See letter from Paul M. Architzel, Esq., Alston & Bird LLP to Terry S. Arbit, General Counsel, CFTC, dated October 13, 2008, at 2.

² See letter from Paul M. Architzel, Esq., Alston & Bird LLP to Terry S. Arbit, General Counsel, CFTC, dated May 5, 2009, at 1-2.

BM&F Bovespa is regulated by the Brazilian Securities and Exchange Commission (Comissão de Valores Mobiliários) (“CVM”). CVM has been responsible for the oversight of the Brazilian securities markets and the enforcement of securities and corporation laws since it was formed in 1976. In 2002, CVM’s jurisdiction was expanded to cover all derivatives markets, either organized on exchanges or traded over-the counter.³

The Ibovespa is a broad-based, liquidity-weighted,⁴ total return index of 66 of the most highly capitalized and liquid stocks, issued by 59 unaffiliated companies, that are currently listed on the BM&F Bovespa.⁵ The Index is designed to represent the overall performance of the Brazilian stock market.⁶ BM&F Bovespa is responsible for the selection of component shares and for the maintenance, calculation and dissemination of the Ibovespa.⁷ Constituent issuers that are eligible for inclusion in the Ibovespa are selected according to an index of their trading intensity, which is determined by number of trades and volume by price. After the shares traded on BM&F Bovespa have been ranked by this trading intensity factor, those shares constituting 80% of all shares traded on BM&F Bovespa are included in the Ibovespa. Shares included in the Index must meet the additional criteria that their trading volume is in excess of 0.1% of total

³ BM&F Bovespa also is subject to regulation by the Central Bank of Brazil (“BACEN”) with respect to financial matters. In addition, both the CVM and BACEN implement resolutions of the Brazilian National Monetary Council (“CMN”), the highest policy-making authority of the Brazilian financial system, composed of the Minister of Finance, the Minister of Planning and Budgeting, and the President of BACEN. See letter from Mr. Architzel to Mr. Arbit, dated October 13, 2008, at 8-9.

⁴ A liquidity-weighted index is an index where the individual component securities are weighted based upon the number of trades and financial trading volume of each of the component securities. The Index is not market capitalization weighted, and as such, the capitalization of each component security is not considered in determining its weighting within the Index. See letter from Mr. Architzel to Mr. Arbit, dated October 13, 2008, at 6 n.8.

⁵ The Index is an accumulation index. Its index number represents the present value of a portfolio begun on January 2, 1968, with a starting value of 100 and taking into account share price increases plus the reinvestment of all dividends, subscription rights and bonus stocks received. *Id.* at 6.

⁶ The Index includes stocks representing a theoretical portfolio that would include more than 80% of the number of trades and the financial volume registered on BM&F Bovespa’s cash market and approximately 70% of the market capitalization of the stocks listed at BM&F Bovespa. *Id.*

⁷ Employees of BM&F Bovespa, including those that are responsible for calculation and adjustment of the Ibovespa, are subject to a “code of conduct” with respect to their trading in futures and securities. *Id.* at 7.

volume of trading on BM&F Bovespa, and that they must be traded on more than 80% of trading days during the preceding twelve months.⁸

Based on data supplied by BM&F Bovespa, the total market capitalization of the stocks comprising the Ibovespa was over U.S.\$ 446 billion as of August 29, 2008.⁹ The largest single security by weight represented about 17.07%, and the five largest securities by weight represented about 40.9%, of the Ibovespa.¹⁰ The securities comprising the lowest 25% of the Ibovespa had an aggregate dollar value of average daily trading volume of about U.S.\$ 440 million over the six-month period ending in August 2008.¹¹ The Ibovespa is calculated in real time and disseminated by electronic means through major data vendors.¹²

Both BM&F Bovespa's full-sized and MINI futures contracts on the Ibovespa provide for cash settlement. The terms and conditions of both contracts are generally identical except for their respective sizes, or the value (in Brazilian Reals, "R\$") of each Index point. Specifically, the value of the full-sized contract is R\$1.00 per Index point, while the value of the MINI contract is R\$0.20 per Index point, or one-fifth the size of the full-sized contract. The minimum price fluctuation of both futures contracts is five Index points. BM&F Bovespa lists for trading the nearest seven months of the February bi-monthly cycle. The last trading day is the Wednesday closest to the 15th calendar day of the contract month, or the following business day if that day is a holiday. Cash settlement is made on the first business day following the last trading day. The final settlement price is determined by taking the average value of the Ibovespa during the last three hours of trading on the last trading day.¹³

⁸ *Id.* The composition of the Index is reviewed 3 times per year. During the review period, the Index is reviewed to determine changes in the weights of each constituent security in the Index, and to determine the maintenance or exclusion of constituent securities from the current Index or the addition of new securities to the Index. In addition to this periodic review process, the Ibovespa may be adjusted at other times for extraordinary corporate events, including spin-offs, mergers, delistings and bankruptcies. *Id.*

⁹ *Id.* at 6.

¹⁰ *Id.* and Attachment 1.

¹¹ *Id.* at 7 and Attachment 1.

¹² *Id.* at 8.

¹³ *Id.* at 11 and Attachment 5, and letter from Paul M. Architzel, Esq., Alston & Bird, LLP to Terry S. Arbit, General Counsel, CFTC, dated March 6, 2008, at 9 and Attachment 5. The contracts are subject to position limits equal to the greater of 20% of the total open interest per contract month for either contract or 10,000 full-sized contracts and 20,000 MINI contracts per contract month. See BM&F Bovespa's website at <<http://www.bmf.com.br>>.

The Commodity Exchange Act (“CEA”),¹⁴ as amended by the Commodity Futures Modernization Act of 2000 (“CFMA”),¹⁵ 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,¹⁶ with the exception of security futures products,¹⁷ over which the Commission shares jurisdiction with the Securities and Exchange Commission (“SEC”).¹⁸ 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).¹⁹

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).²⁰ 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.²¹

¹⁴ 7 U.S.C. § 1 *et seq.*

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

¹⁶ See CEA Section 2(a)(1)(C)(ii).

¹⁷ 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).

¹⁸ See CEA Section 2(a)(1)(D).

¹⁹ See CEA Section 2(a)(1)(C)(ii).

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

²¹ 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

While CEA 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.²²

Accordingly, Commission staff has examined the Ibovespa and BM&F Bovespa's full-sized and MINI futures contracts based thereon, to determine whether the Index and the 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 Ibovespa, and BM&F Bovespa's full-sized and MINI futures contracts based thereon, conform to these requirements.²³

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 Ibovespa are listed and traded on BM&F Bovespa, which has unified its market surveillance function for

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).

²² 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.

²³ In making this determination, Commission staff has concluded that the Ibovespa does not have any of the elements of a narrow-based security index as enumerated in CEA Section 1a(25)(A). Accordingly, the Index would not be a narrow-based security index if traded on a designated contract market or DTEF.

securities and futures trading. Accordingly, BM&F Bovespa should have access to information with respect to the securities underlying the Ibovespa necessary to detect and deter manipulation. In the event that BM&F Bovespa is unable to obtain access to adequate surveillance data in this regard, or is unable, either directly or through CVM, to share such data with the CFTC, this Office reserves the right to reconsider the position we have taken herein.²⁴

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 BM&F Bovespa's full-sized and MINI futures contracts based on the Ibovespa 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 BM&F Bovespa with all regulatory requirements imposed by the CVM, CMN and BACEN, and the applicable laws and regulations of Brazil. 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.

BM&F Bovespa also has requested that, upon issuance of the relief granted herein, it be permitted to make its full-sized and MINI futures contracts based on the Ibovespa available for trading through direct access from the U.S. to its automated trading system in accordance with the terms and conditions of the no-action letter dated September 26, 2008, ("September 26, 2008 letter") issued by Commission staff to BM&F Bovespa.²⁵ In this regard, BM&F Bovespa has

²⁴ BM&F Bovespa has confirmed that it is willing and able to cooperate through information sharing and other means with the Commission, either directly to the extent permitted by Brazilian law or through its regulator, the CVM, in relation to the trading on BM&F Bovespa of the full-sized and MINI futures contracts on the Ibovespa. See letter from Mr. Architzel to Mr. Arbit, dated October 13, 2008, at 10. BM&F Bovespa has been granted Regulation 30.10 relief by the Commission. See 67 Fed. Reg. 45056 (CFTC July 8, 2002). BM&F Bovespa also is a signatory to the International Information Sharing Memorandum of Understanding and Agreement signed on March 15, 1996, at Boca Raton, Florida, a framework for over 60 futures exchanges and clearing organizations worldwide to share information relevant to managing global market emergencies.

In addition, BM&F Bovespa's regulator, the CVM, and the CFTC on April 12, 1991, entered into a Memorandum of Understanding on Mutual Assistance and Exchange of Information. In connection with BM&F Bovespa's Regulation 30.10 petition, CVM as well as BM&F Bovespa, confirmed that they would share with the CFTC information relevant to BM&F Bovespa transactions proposed to be entered into with or on behalf of U.S. customers. The CVM also is a signatory to the Declaration on Cooperation and Supervision of International Futures Markets and Clearing Organizations for the sharing of large exposure information, signed on March 15, 1996, at Boca Raton, Florida.

²⁵ See CFTC Staff Letter No. 08-18, [Current Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 30,928 (Sep. 26, 2008).

certified that it is in compliance with the terms and conditions of the September 26, 2008 letter.²⁶ We have consulted with the Commission's Division of Market Oversight ("Division"), which is the Division in the Commission that administers foreign direct access no-action letters. The Division has concluded that allowing BM&F Bovespa to make its full-sized and MINI futures contracts on the Ibovespa available for trading pursuant to the September 26, 2008 letter would not be contrary to the public interest. Accordingly, on behalf of the Division, this Office hereby confirms that the relief granted to BM&F Bovespa in the September 26, 2008 letter extends to BM&F Bovespa's full-sized and MINI futures contracts based on the Ibovespa.

In addition, BM&F Bovespa has requested confirmation that two "structured transactions" involving its Ibovespa and MINI Ibovespa futures contracts would not require separate relief apart from the relief granted by this letter in order to make them available for direct access from the U.S. pursuant to the September 26, 2008 letter.²⁷ These transactions include the Ibovespa Rollover and Forward Points on the Ibovespa.²⁸ BM&F Bovespa asserts that these structured transactions are not separate futures contracts on the Ibovespa, but rather are an alternative means of trading its futures contracts on the Index. Neither of these transactions create or result in open interest that is separate or apart from the futures contracts on the Ibovespa that are the subject of the relief granted herein. Accordingly, this Office confirms that BM&F Bovespa's structured transactions may be made available in the U.S. without further relief apart from the relief granted by this letter with respect to its full-sized and MINI futures contracts on the Ibovespa, and, on behalf of the Division, may be made available through direct access from the U.S. pursuant to the September 26, 2008 letter.

The offer and sale in the U.S. of BM&F Bovespa's full-sized and MINI futures contracts on the Ibovespa, including its structured transactions based thereon, 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.²⁹

Sincerely,

²⁶ See letter from Mr. Architzel to Mr. Arbit dated October 13, 2008, at 17, and letter from Mr. Architzel to Mr. Arbit dated May 5, 2009, at 3.

²⁷ See letter from Mr. Architzel to Mr. Arbit, dated October 13, 2008, at 13-15.

²⁸ The Ibovespa Rollover is a calendar spread that enables a trader to execute contracts in two contract maturities simultaneously in one transaction. The Forward Points method of trading permits basis trading in relation to the lead trading month of the futures contract on the Ibovespa. Basis trading is a trading method in which futures contracts are traded with reference to a price quoted in relation to Index points that are then added to or subtracted from the day's average price of the Ibovespa in the cash market. Such trading enables traders to execute their futures contracts at a price related to the average price of the underlying Index. BM&F Bovespa's Circular Letter 066/2002, dated May 6, 2002, states that "[t]his strategy does not create a new futures contract. It is only an alternative way to trade the Ibovespa futures contract."

²⁹ See 17 C.F.R. Part 30.

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