CFTC letter No. 03-35
October 17, 2003
No-Action
Office of General Counsel

Mr. Ravi Narain
Managing Director and Chief Executive Officer
National Stock Exchange of India Limited
“Exchange Plaza”
Bandra-Kurla Complex
Bandra (E)
Mumbai 400051
INDIA

Re: National Stock Exchange of India Limited’s Request for No-Action Relief in Connection with the Offer and Sale of its Futures Contract Based on the Standard & Poors CNX Nifty Index in the United States

Dear Mr. Narain:

This is in response to letters, attachments, facsimiles and electronic mail dated from June 16, 2000 to August 14, 2003, requesting that the Office of General Counsel (“Office”) of the Commodity Futures Trading Commission (“Commission” or "CFTC") issue to the National Stock Exchange of India, Limited (“NSE”), a “no-action” letter concerning the offer and sale in the United States (“U.S.”) of NSE’s futures contract based on the Standard & Poors CNX Nifty Index (“S&P CNX Nifty” or “Index”). [1]

We understand the facts to be as follows. NSE is the largest securities and derivatives exchange in India in terms of trading volume. It was granted formal approval as an exchange under the Securities Contract Regulation Act, 1956, in 1993 and commenced operations in 1994. NSE operates three separate segments: a Capital Market segment (where equities and retail debt trades are executed), a Wholesale Debt Market segment (an inter-institutional bond market), and a Futures and Options segment. NSE is regulated by the Securities and Exchange Board of India (“SEBI”), which approved NSE’s S&P CNX Nifty futures contract for trading.[2] SEBI was established by the Securities and Exchange Board of India Act, 1992 (“SEBI Act”), and is responsible for regulating securities and derivatives trading in India.[3]

The S&P CNX Nifty is designed to be a benchmark index for the Indian stock market. The Index, owned and managed by India Index Services and Products, Ltd. (“IISL”),[4] is a broad-based, capitalization-weighted composite security index composed of 50 of the largest stocks, in terms of market capitalization, and the most liquid stocks, in terms of market impact cost, traded in India on the

NSE. Based on data supplied by NSE, the total market capitalization of the S&P CNX Nifty was U.S. $66.3 billion as of March 31, 2003.[5] Also as of that date, the largest single stock by weight represented 12.26%, and the five most heavily weighted stocks represented 45.01%, of the S&P CNX Nifty.[6] The stocks comprising the lowest 25% of the S&P CNX Nifty had a six-month aggregate dollar value of average daily trading volume in excess of U.S. $30 million: approximately U.S. $96.9 million for the 6-month period ending March 2003.[7] The S&P CNX Nifty is calculated in real time and is disseminated by electronic means through major data vendors, such as Bloomberg and Reuters.[8]

NSE's futures contract on the S&P CNX Nifty provides for cash settlement in Rupees ("Rs"). Prices are quoted in Index points with each Index point equal to Rs200 per contract. The minimum price fluctuation is 0.05 Index point, equal to Rs10 per contract. NSE lists for trading the three nearest calendar months. The contract is listed for trading from 9:55 a.m. to 3:30 p.m. Mumbai time, Monday through Friday. The last trading day is the last Thursday of the contract month. Cash settlement occurs on the day following the last trading day. The final settlement price for the contract is the closing spot Index on the last day of trading. The spot Index level is based on the weighted average prices of the component stocks during the last 30 minutes of trading.[9]

The Commodity Exchange Act ("CEA"),[10] as amended by the Commodity Futures Modernization Act of 2000 ("CFMA"),[11] 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,[12] with the exception of security futures products,[13] over which the Commission shares jurisdiction with the Securities and Exchange Commission ("SEC").[14] 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).[15]

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 United States, except as permitted under CEA Section 2(a)(1)(C)(ii) or CEA Section 2(a)(1)(D).[16] 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.[17]

While Section 2(a)(1)(C)(ii) provides that no board of trade 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.[18]

Accordingly, this Office has examined the S&P CNX Nifty and NSE's futures contract based thereon to determine whether the Index and the futures contract meet the requirements enumerated in CEA Section 2(a)(1)(C)(ii). 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 S&P CNX Nifty and NSE's futures contract based thereon conform to these requirements.[19]

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 equity securities underlying the S&P CNX Nifty are traded on NSE. Although some of these securities are traded on other stock exchanges in India, the SEBI has established an Inter-Exchange Surveillance Group to facilitate inter-exchange surveillance and information sharing.[20] Thus, NSE should have access to information necessary to detect and deter manipulation. In the event that NSE 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.[21]

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 NSE's S&P CNX Nifty 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 NSE with all regulatory requirements imposed by SEBI, and the applicable laws and regulations of India. 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.

The offer and sale in the U.S. of NSE's S&P CNX Nifty futures contract is, of course, subject to Part 30 of the Commission's regulations, which govern the offer and sale of foreign futures and foreign option contracts in the U.S.[22]

Sincerely,

Patrick J. McCarty
General Counsel

---

[1]The NSE initially requested a no-action letter based on the S&P CNX Nifty in correspondence dated June 16, 2000. That request was deemed withdrawn by this Office in correspondence dated February 13, 2003. On April 9, 2003, NSE submitted a new application for a no-action letter. The facts mentioned in this letter are drawn from materials submitted under both applications.

[2]Before approving an exchange for trading futures contracts on a security index, SEBI must find that the exchange has rules which ensure, among other things, that the exchange has an online surveillance capability which monitors positions, prices and volume in real-time to deter market manipulation, that the exchange disseminates information about trades, quantities and quotes in real-time over at least two information vending networks that are accessible to investors, and that the exchange has a satisfactory record of monitoring its members, handling investor complaints and preventing irregularities in trading. *See* letter from Ravi Narain, Managing Director and Chief Executive Officer, NSE, to C. Robert Paul, General Counsel, CFTC, dated June 16, 2000.

[3]As a result of amendments to the SEBI Act in October of 2002, the SEBI's powers were enhanced to check cases of insider trading, fraudulent and unfair trading practices and market manipulation in order to protect investors. Further information regarding the SEBI and the laws and regulations governing securities and derivatives trading in India can be found on the SEBI's website, <http://www.sebi.gov.in>.

[4]IISL is a joint venture between the NSE and Credit Rating Information Services of India, Limited, a leading credit rating agency in India. IISL has a consulting and licensing agreement with S&P, for co-branding equity indices of IISL, including the S&P CNX Nifty. NSE has entered into an agreement with IISL for introducing futures contracts on the S&P CNX Nifty. *See* electronic mail from R. Sundararaman, Assistant Vice President, NSE, to Patrick J. McCarty, General Counsel, CFTC, dated April 9, 2003. The NSE and IISL follow a code of conduct that includes strict confidentiality guidelines and Chinese walls between NSE officials with access to data on Index components and the members of the Index maintenance committee. *See* letter from Ravi Narain, Managing Director and Chief Executive Officer, NSE, to David R. Merrill, Deputy General Counsel, CFTC, dated December 4, 2000.

[5]*See* electronic mail from Mr. Sundararaman to Mr. McCarty, dated April 9, 2003 (Annexure 1, Table 1).

[6]*Id.*

[7]*See id.* (Annexure B) and letter from R. Sundararaman, Assistant Vice President, NSE to Julian E. Hammar, Counsel, CFTC, dated May 19, 2003.

[8]*See* electronic mail from Mr. Sundararaman to Mr. McCarty, dated April 9, 2003.

[9]*Id.*

[10]7 U.S.C. § 1 *et seq.*

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

[12]*See* CEA Section 2(a)(1)(C)(ii).

[13]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).

[14]*See* CEA Section 2(a)(1)(D).

[15]*See* CEA Section 2(a)(1)(C)(ii).

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

[17]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).

[18]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.

[19] In making this determination, the Commission staff has concluded that the S&P CNX Nifty does not have any of the elements of a narrow-based security index as enumerated in CEA Section 1a(25)(A), and accordingly the Index would not be a narrow-based security index if traded on a designated contract market or DTEF.

[20] *See* letter from Mr. Narain to Mr. Merrill, dated December 4, 2000.

[21] NSE represents that there are no blocking statutes in India that would inhibit the ability of the CFTC to obtain information regarding trading in futures contracts on security indices. *See* letter from Mr. Sundararaman to Mr. Hammar, dated May 19, 2003. In addition, NSE has confirmed that it is willing and able to share information with the CFTC concerning its futures contract on the S&P CNX Nifty and the securities underlying the Index. *See* letter from Chitra Ramkrishna, Deputy Managing Director, NSE, to Patrick J. McCarty, General Counsel, CFTC, dated August 14, 2003. With regard to information sharing with exchanges outside of India that trade securities underlying the Index, NSE has signed memoranda of understanding with the London Stock Exchange and Singapore Derivatives Trading Limited that provide for market surveillance information sharing. *See* letter from Mr. Narain to Mr. Merrill, dated December 4, 2000.

The NSE's regulator, the SEBI, is a signatory to the International Organization of Securities Commission's Multilateral Memorandum of Understanding Concerning Consultation and Cooperation and the Exchange of Information (May 2002) ("IOSCO MOU"). The IOSCO MOU, to which the CFTC is also a signatory, is a multilateral mechanism for sharing information on a bilateral basis between regulators. Prior to signing the IOSCO MOU, a regulator must establish through a fair and transparent process that it has the legal capacity to fulfill its terms and conditions. The SEBI has also entered into an information sharing arrangement with the U.S. Securities and Exchange Commission. *See* letter from Mr. Narain to Mr. Paul, dated June 16, 2000.

[22] *See* 17 C.F.R. Part 30.