



UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549

July 2, 2015

Christopher Kirkpatrick  
Secretary  
Commodity Futures Trading Commission  
Three Lafayette Centre  
1155 21st Street NW  
Washington, DC 20581

Re: Chicago Mercantile Exchange Inc. Submission of Standard and Poor's 500 Dividend Index Futures for Commission Review and Approval per Section 5c(c) of the Commodity Exchange Act and Regulation §40.3 (CME Submission No. 10-195)

Dear Mr. Kirkpatrick:

The Chicago Mercantile Exchange ("CME") has voluntarily submitted a futures contract based on the S&P 500 Dividend Index to the Commodity Futures Trading Commission ("CFTC") for review and approval in accordance with Section 5c(c) of the Commodity Exchange Act ("CEA") and Regulation §40.3 thereunder.<sup>1</sup> The CME's proposed product raises substantial legal and policy concerns. We appreciate the discussions we have had to date with the staff of the CFTC on the product. In order to further these discussions, staff from the Division of Trading and Markets and the Division of Corporation Finance of the Securities and Exchange Commission ("SEC") would like to offer the following brief comments and analysis with respect to the product, as well as to offer possible solutions that would allow the product to move forward while addressing these legal and policy concerns.

The staffs of the SEC and the CFTC (the "Commissions") have a long history of cooperating to find solutions to facilitate trading and appropriate market oversight of futures that may be classified as security futures under Section 1a(44) of the CEA, Section 2(a)(16) of the Securities Act of 1933 ("Securities Act"), and Section 3(a)(55) of the Securities Exchange Act of 1934 ("Exchange Act").<sup>2</sup> Because the definition of "security future" appears in statutes

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<sup>1</sup> See letter from Stephen M. Szarmack, Regulatory Counsel, CME Group, to David Stawick, Office of the Secretariat, Commodity Futures Trading Commission (CME Submission No.10-195) (July 14, 2010) (available at [www.cftc.gov](http://www.cftc.gov)). We understand that the CME has consented to extensions of the review period for its filing.

<sup>2</sup> A security future is a security for purposes of both the Securities Act and the Exchange Act, pursuant to Sections 2(a)(1) and 3(a)(10) of those acts, respectively.

separately administered by each of the SEC and CFTC, neither agency has the final say on whether a product is a security future across all three of those acts. Accordingly, this cooperation is particularly important.

Both staffs have long recognized that the definition of narrow-based security index was drafted with equity indexes in mind, and that the two Commissions must work together to devise appropriate characterizations of other types of indexes. For example, the Commissions jointly have granted relief to allow futures on certain volatility indexes (in 2004 and 2009) and futures on certain debt indexes (in 2006) – each of which qualified as a narrow-based security index due to the absence of public trading of the index components – to trade as if the underlying indexes were broad-based. This relief gave legal certainty to futures on these indexes, which could have traded only as security futures absent such joint action by the Commissions.

The discussions we have had to date have made clear that the product raises a novel question of how to analyze a future on a dividend index under the relevant statutory provisions. Once again, we believe it is important that the Commissions work together as Congress intended to facilitate trading while protecting the markets and investors, particularly given the legal uncertainty that exists with respect to the product.

A security future subject to the joint jurisdiction of the Commissions includes a future on “a single security or a narrow-based security index, including any interest therein or based on the value thereof.”<sup>3</sup> As a starting point, it is important to note that the S&P 500 Dividend Index must be distinguished from the S&P 500 Index.

In 2009, when analyzing an option on the S&P 500 Dividend Index+, the SEC reiterated that “[t]he concept of an ‘interest in’ a security plainly includes rights generating a pecuniary interest in a security, such as the right to a dividend payout or bond (coupon) payment.”<sup>4</sup> Accordingly, the SEC found that “options on the value of dividends declared by the issuers of component securities of a group or index of securities are options on an interest in, or based on the value of an interest in, that group or index of securities.”<sup>5</sup> Based on this precedent, the S&P 500 Dividend Index can therefore be characterized as an index of interests in securities.<sup>6</sup>

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<sup>3</sup> Section 1a(44) of the CEA; Section 3(a)(55)(A) of the Exchange Act.

<sup>4</sup> See Self-Regulatory Organizations; Chicago Board Options Exchange, Incorporated; Notice of Filing of Amendment No. 1 and Order Granting Accelerated Approval of Proposed Rule Change, as Modified by Amendment No. 1, to List and Trade S&P 500 Dividend Index Options, Exchange Act Release No. 61136 (Dec. 10, 2009), 74 FR 66711, 66713 (Dec. 16, 2009) (“2009 CBOE Order”) (quoting Exchange Act Release No. 55781 (June 6, 2007), 72 FR 32372, 32376 (June 12, 2007)).

<sup>5</sup> See 2009 CBOE Order, 74 FR 66711, 66713 (Dec. 16, 2009).

<sup>6</sup> In the context of swaps and security-based swaps, where the definition of narrow-based security index is also relevant, the SEC and the CFTC stated that a “security index in most cases is designed to reflect the performance of a market or sector by reference to representative securities or interests in securities.” See Further Definition of “Swap,” “Security-Based Swap,”

Consistent with the position taken by the SEC in the 2009 CBOE Order and by the two agencies together in the 2012 Joint Release (further defining the term “narrow-based security index”), and to give meaning to the phrase “including any interest therein or based on the value thereof” in the definition of security future, we believe that a narrow-based security index can include an index of interests in securities. To determine whether the S&P 500 Dividend Index is a narrow-based index, we look to the statutory definition of “narrow-based security index.”<sup>7</sup> That definition includes four tests, and if any of these tests is satisfied, the index is narrow-based. We believe the index may be viewed as satisfying all four tests, including the test that the components of the index have an average daily trading volume below specified thresholds.<sup>8</sup> Dividend indexes, like volatility indexes and debt indexes (at least before the Commissions offered their joint relief), satisfy this test because dividend interests do not directly trade in public markets. As a result, we believe that there is a reasonable basis to conclude that futures on the S&P 500 Dividend Index could be viewed as security futures, and at a minimum that there is legal uncertainty as to whether a court would characterize the product as a security future.

An additional issue of concern to us is the risk that the CME’s product could be used for insider trading, and could impact the pricing of equity securities whose dividends are included in the dividend index on which a future is traded. Information about an upcoming dividend announcement, like information about an upcoming announcement of corporate earnings, may be particularly susceptible to illegal insider trading before such decisions are announced publicly. Congress recognized this when it created the SEC in 1934, having identified instances of insider trading on the basis of non-public dividend decisions.<sup>9</sup> Since that time, in enforcing the insider trading prohibitions the SEC has often brought cases involving trading on non-public information about upcoming dividend announcements.<sup>10</sup>

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and “Security-Based Swap Agreement”; Mixed Swaps; Security-Based Swap Agreement Recordkeeping, 77 FR 48208, 48285 (Aug. 13, 2012) (“2012 Release”).

<sup>7</sup> Section 1a(35)(A) of the CEA; Section 3(a)(55)(B) of the Exchange Act.

<sup>8</sup> See Section 1a(35)(A)(iv) of the CEA; Section 3(a)(55)(B)(iv) of the Exchange Act.

<sup>9</sup> For example, the Senate Committee on Banking and Currency cited an instance of company officers participating in a pool organized to trade in the stock of their company when the stock was not paying dividends. The officers then caused the company to resume payment of dividends out of surplus earnings, with twenty-five percent of the dividends paid to the pool’s participants. The Committee also recounted an instance of controlling shareholders who disposed of their holdings shortly before the company passed a dividend and later repurchased them, netting a fifty-three percent profit. See Federal Securities Exchange Act of 1934, Senate Rpt. No. 73-792 (Apr. 17, 1934).

<sup>10</sup> See, e.g., SEC v. Johnson, Litig. Rel. No. 19363, 86 SEC Docket 444 (Sept. 7, 2005); SEC v. Hertz, 85 SEC Docket 2039 (June 14, 2005); SEC v. Prevost, Litig. Rel. No. 14989, 62 SEC Docket 1174 (July 23, 1996); SEC v. Potts, Litig. Rel. No. 14561, 59 SEC Docket 2114 (July 17, 1995); SEC v. General Dynamics Corp., 19 SEC Docket 792 (Feb. 27, 1980); In Re Cady, Roberts & Co., 40 SEC Docket 907 (Nov. 8, 1961).

In particular, an issuer's decision to declare or not to declare a dividend and, if so, at what level, could impact the value of the S&P 500 Dividend Index at levels that could prove to be attractive to persons who are seeking to profit illegally from non-public information concerning dividends. Additionally, the value of a dividend index representing a large number of issuers may in practice depend upon the market's expectations of dividend announcements from a smaller number or more highly concentrated pool of issuers, which could increase the potential for the S&P 500 Dividend Index future to be used as a vehicle for insider trading.

In addition, we have concerns regarding the impact that trading in dividend index products, such as the S&P 500 Dividend Index future, could have on the pricing of equity securities whose dividends are included in a dividend index on which a future is traded (particularly around dividend announcements) due to arbitrage relationships, which have the effect of linking related futures, options, and equity markets. In other words, and for example, insider trading in dividend index products, such as the S&P 500 Dividend Index future, might impact not just futures market participants, but also retail investors and other investors in the securities markets.

Our concerns with insider trading and the potential impact on the pricing of equity securities in the securities markets would be even greater with respect to a dividend index related to fewer issuers such as a dividend index on the Nasdaq 100 or the Dow Jones Industrial Average.

Because of the potential impact of trading in futures on interests in securities for investors in securities and the securities markets, and the legal uncertainty regarding how to characterize the product under the relevant statutory provisions, we believe that it is in the interests of both agencies to coordinate our regulatory approach to such products. Since the CME submitted its proposal, the SEC staff has been working closely with the CFTC staff to find a workable solution to these significant policy and legal concerns for both agencies, and for the market. We note here two possible alternatives that, if approved by our respective Commissions, would allow the proposed S&P 500 Dividend Index futures to trade on or subject to the rules of a board of trade together with futures subject to the CFTC's exclusive jurisdiction. Each alternative would offer to the CME and market participants certainty about the product's legal status.

Under the first option, the staffs would recommend to their respective Commissions that each Commission provide legal certainty to the trading of S&P 500 Dividend Index futures on or subject to the rules of a board of trade as if they were not security futures. Under this approach, the futures would be exempted from most provisions of the Exchange Act and the CEA related to security futures on a "legal certainty" basis (*i.e.*, without addressing the legal status of the products),<sup>11</sup> though the SEC would retain the ability to assert anti-fraud and anti-manipulation

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<sup>11</sup> "Legal certainty" exemptions have been used by the agencies in similar situations to permit products to trade. For example, the CFTC granted "legal certainty" exemptions to options on gold and silver exchange-traded trusts in 2008 and 2010. *See, e.g.*, CFTC Order Exempting the Trading and Clearing of Certain Products Related to SPDR® Gold Trust Shares, 73 FR 31981

authority over transactions in the product. Consistent with what we understand to be the CME's obligations under the CEA, the CME would conduct surveillance to identify potential illegal insider trading. In addition, at the SEC's request, the CME would produce books and records concerning transactions in the product. Under this approach, the SEC order issued in connection with this option would also address the legal uncertainty (which could manifest itself in the form of rescission rights) that potentially would exist under the Securities Act if the products traded in the absence of an effective Securities Act registration statement. Considerable effort has already been made to develop this option.

Under the second option, the staffs would recommend to their respective Commissions that the two Commissions exercise their joint authority under the relevant statutory provisions to declare that the S&P 500 Dividend Index is not a narrow-based security index and, therefore, that futures on the index are not security futures. As a result, the CME's proposed S&P 500 Dividend Index futures (as well as any other subsequently proposed futures on the index) would become futures on a broad-based security index subject to the exclusive jurisdiction of the CFTC. Because such futures would not be security futures, the registration requirements of the Securities Act would not apply by operation of the joint authority. This option would be similar to the actions that the Commissions have jointly taken in relation to volatility indexes and debt indexes. To address the potential for illegal insider trading that this product presents, the relief would be conditioned on the CME conducting surveillance to identify potential illegal insider trading (again, consistent with what we understand to be the CME's obligations under the CEA), and the joint order would describe how the CFTC would exercise its anti-fraud authority, focusing on its ability to police for insider trading and market manipulation involving the product.

We believe that the two options described above represent workable ways to permit the product to trade in a manner favored by CFTC staff and the CME, while addressing the

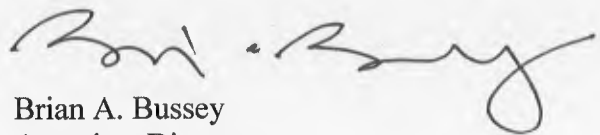
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(June 5, 2008); CFTC Order Exempting the Trading and Clearing of Certain Products Related to iShares® COMEX Gold Trust Shares and iShares® Silver Trust Shares, 73 FR 79830 (Dec. 30, 2008); CFTC Order Exempting the Trading and Clearing of Certain Products Related to ETFS Physical Swiss Gold Shares and ETFS Physical Silver Shares, 75 FR 37406 (June 29, 2010); and CFTC Order Exempting the Trading and Clearing of Certain Products Related to the CBOE Gold ETF Volatility Index and Similar Products. The CFTC used those exemptions as a basis to approve submissions from The Options Clearing Corporation related to those products. Similar filings relating to the clearance and settlement of transactions in options on ETFS Palladium Shares and ETFS Platinum Shares are currently pending before the CFTC. See, e.g., Rule Filing SR-OCC-2010-03-Request for Commission Rule Approval (available at: <http://www.cftc.gov/stellent/groups/public/@rulesandproducts/documents/ifdocs/rul030110occ001.pdf>).

substantial policy and legal concerns with the CME's submission in a narrowly tailored fashion. We stand ready to work cooperatively with the CFTC staff on an expedited basis to work through either or both of these options, or to consider other options that not only provide needed legal certainty to market participants, but also ensure the availability and use of regulatory tools to address the potential for illegal insider trading and the potential for impact on equity pricing in the securities markets.

We appreciate the opportunity to comment on the CME submission.<sup>12</sup> Should you require any further information, please do not hesitate to contact either of us.

Sincerely,



Brian A. Bussey  
Associate Director  
Division of Trading and Markets



David R. Fredrickson  
Associate Director and Chief Counsel  
Division of Corporation Finance

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<sup>12</sup> This letter reflects only the views of the undersigned divisions and not the views of the SEC or any other division or office within the SEC.