

COMMODITY FUTURES TRADING COMMISSION

SECURITIES AND EXCHANGE COMMISSION

(Release No. 34-61027)

Joint Order Modifying the Listing Standards Requirements under Section 6(h) of the Securities Exchange Act of 1934 and the Criteria under Section 2(a)(1) of the Commodity Exchange Act

The Securities Exchange Act of 1934 ("Exchange Act") and the Commodity Exchange Act ("CEA") set forth the types of securities on which security futures<sup>1</sup> can be based. The Exchange Act provides that it is unlawful for any person to effect transactions in security futures that are not listed on a national securities exchange or a national securities association registered pursuant to Section 15A of the Exchange Act.<sup>2</sup> The Exchange Act further provides that such exchange or association is permitted to trade only security futures that conform with listing standards filed with the Securities and Exchange Commission ("SEC") and that meet the criteria specified in Section 2(a)(1)(D)(i) of the CEA.<sup>3</sup> Section 2(a)(1)(D)(i) of the CEA permits the Commodity Futures Trading Commission ("CFTC") to designate a board of trade as a contract market with respect to, or to register as a derivatives transaction execution facility to list or execute, transactions in security futures if the board of trade and the applicable contract meet the criteria specified in that section. Similarly, the Exchange Act requires that the listing standards filed with the SEC by an exchange or association meet specified requirements.<sup>4</sup>

Among other things, the Exchange Act and the CEA require that any security underlying a security future, including each component security of a narrow-based security index, except as

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<sup>1</sup> Security futures are futures contracts on single securities and narrow-based security indexes. See Section 3(a)(55)(A) of the Exchange Act, 15 U.S.C. 3(a)(55)(A), and Section 1a(31) of the CEA, 7 U.S.C. 1a(31).

<sup>2</sup> Section 6(h)(1) of the Exchange Act, 15 U.S.C. 78f(h)(1).

<sup>3</sup> Section 6(h)(2) of the Exchange Act, 15 U.S.C. 78f(h)(2). See also 7 U.S.C. 2(a)(1)(D)(i).

<sup>4</sup> Section 6(h)(3) of the Exchange Act, 15 U.S.C. 78f(h)(3).

otherwise provided in a rule, regulation, or order, be registered pursuant to Section 12 of the Exchange Act.<sup>5</sup> In 2006, the SEC and CFTC (together, the “Commissions”) adopted SEC Rule 6h-2<sup>6</sup> and an amendment to CEA Rule 41.21,<sup>7</sup> respectively, to permit security futures to be based on individual debt securities or narrow-based indexes composed of such securities.<sup>8</sup> However, because most debt securities are not registered under Section 12 of the Exchange Act,<sup>9</sup> few security futures based on debt securities can be listed.

In addition, the Exchange Act<sup>10</sup> and the CEA<sup>11</sup> require that security futures be based upon common stock and such other equity securities as the Commissions may jointly determine to be appropriate. Pursuant to this authority, the Commissions previously issued joint orders to permit depository shares<sup>12</sup> and shares of Exchange-Traded Funds, Trust Issued Receipts, and shares of registered closed-end management investment companies<sup>13</sup> to underlie security futures (together,

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<sup>5</sup> Section 6(h)(3)(A) of the Exchange Act, 15 U.S.C. 78f(h)(3)(A), and Section 2(a)(1)(D)(i)(I) of the CEA, 7 U.S.C. 2(a)(1)(D)(i)(I).

<sup>6</sup> 17 CFR 240.6h-2.

<sup>7</sup> 17 CFR 41.21.

<sup>8</sup> See Securities Exchange Act Release No. 54106 (July 6, 2006) 71 FR 39534 (July 13, 2006) (“2006 Rulemaking”).

<sup>9</sup> In this regard, the Commissions note that, in a 2005 request for exemptive relief to permit its members, brokers, and dealers to trade certain unregistered debt securities, the New York Stock Exchange (“NYSE”) estimated that, out of over 22,000 publicly offered corporate bond issues having a par value in excess of \$3 trillion, only 8% of the \$3 trillion par value of these debt securities was registered under the Exchange Act. See Securities Exchange Act Release No. 51998 (July 8, 2005), 70 FR 40748 (July 14, 2005). The SEC granted the NYSE’s request for exemptive relief, subject to certain conditions. See Securities Exchange Act Release No. 54766 (November 16, 2006), 71 FR 67657 (November 22, 2006) (File No. S7-06-05) (“NYSE Exemption”).

<sup>10</sup> 15 U.S.C. 78f(h)(3)(D).

<sup>11</sup> 7 U.S.C. 2(a)(1)(D)(i)(III).

<sup>12</sup> See Securities Exchange Act Release No. 44725 (August 20, 2001).

<sup>13</sup> See Securities Exchange Act Release No. 46090 (June 19, 2002), 67 FR 42760 (June 25, 2002).

the “Prior Joint Orders”). There are, however, other types of securities that underlie listed options that are neither common stock nor covered by the Prior Joint Orders.

Section 6(h)(4)(A) of the Exchange Act<sup>14</sup> and Section 2(a)(1)(D)(v)(I) of the CEA<sup>15</sup> provide that the Commissions, by rule, regulation, or order, may jointly modify the listing standard requirements specified in Sections 6(h)(3)(A) and (D) of the Exchange Act<sup>16</sup> and the criteria specified in Sections 2(a)(1)(D)(i)(I) and (III) of the CEA<sup>17</sup> to the extent that such modification fosters the development of fair and orderly markets in security futures products, is necessary or appropriate in the public interest, and is consistent with the protection of investors. For the reasons and subject to the conditions discussed below, the Commissions believe that jointly modifying these requirements to permit any security that is eligible to underlie options traded on a national securities exchange to also underlie security futures, and to permit debt securities that are not registered under Section 12 of the Exchange Act (“unregistered debt securities”) to underlie security futures, will foster the development of fair and orderly markets, is necessary or appropriate in the public interest, and is consistent with the protection of investors.

I. Discussion

A. Security Futures Based on Securities Eligible to Underlie Options Traded on a National Securities Exchange

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<sup>14</sup> 15 U.S.C. 78f(h)(4)(A).

<sup>15</sup> 7 U.S.C. 2(a)(1)(D)(v)(I).

<sup>16</sup> 15 U.S.C. 78f(h)(3)(A) and (D).

<sup>17</sup> 7 U.S.C. 2(a)(1)(D)(i)(I) and (III).

Section 6(h)(3)(D) of the Exchange Act<sup>18</sup> and Section 2(a)(1)(D)(i)(III) of the CEA<sup>19</sup> require that security futures be based upon common stock and such other equity securities as the Commissions jointly determine appropriate. Section 6(h)(4)(A) of the Exchange Act<sup>20</sup> and Section 2(a)(1)(D)(v)(I) of the CEA<sup>21</sup> provide that the Commissions, by rule, regulation, or order, may jointly modify this requirement to the extent that such modification fosters the development of fair and orderly markets in security futures products, is necessary or appropriate in the public interest, and is consistent with the protection of investors.

The Commissions now believe that modifying the requirement in Section 6(h)(3)(D) of the Exchange Act and Section 2(a)(1)(D)(i)(III) of the CEA to permit any security that is eligible to underlie options traded on a national securities exchange to also underlie security futures will foster the development of fair and orderly markets in security futures products, is appropriate in the public interest, and is consistent with the protection of investors.

To be eligible to underlie options traded on a national securities exchange, and, pursuant to this order, eligible to underlie security futures, a security must meet securities options listing standards of a national securities exchange. Options listing standards of a national securities exchange are rules of an exchange, and, as such, must be filed with the SEC pursuant to Section 19(b) of the Exchange Act,<sup>22</sup> and comply with Section 6(b) of the Exchange Act.<sup>23</sup> Section 6(b)(5) of the Exchange Act,<sup>24</sup> in particular, requires, among other things, that the rules of a

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<sup>18</sup> 15 U.S.C. 78f(h)(3)(D).

<sup>19</sup> 7 U.S.C. 2(a)(1)(D)(i)(III).

<sup>20</sup> 15 U.S.C. 78f(h)(4)(A).

<sup>21</sup> 7 U.S.C. 2(a)(1)(D)(v)(I).

<sup>22</sup> 15 U.S.C. 78s(b).

<sup>23</sup> 15 U.S.C. 78f(b).

<sup>24</sup> 15 U.S.C. 78f(b)(5).

national securities exchange be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, to remove impediments to and perfect the mechanism of a free and open market and a national market system and, in general, to protect investors and the public interest. The SEC may not approve an options exchange's proposed rule, including a proposed options listing standard, unless the SEC finds that it is consistent with the requirements of the Exchange Act, including Section 6(b),<sup>25</sup> and the rules and regulations under the Exchange Act. Accordingly, the Commissions believe that it is appropriate in the public interest and consistent with the protection of investors to modify the listing standard requirements in Section 6(h)(3)(D) of the Exchange Act and Section 2(a)(1)(D)(i)(III) of the CEA to permit any security that is eligible to underlie options traded on a national securities exchange to also underlie security futures. In addition, the Commissions believe that this modification of the listing standard requirements in the Exchange Act and the CEA will reduce impediments to the listing of security futures by allowing the creation of potentially useful new financial instruments, thereby fostering the development of fair and orderly markets in security futures. The Commissions believe, further, that it is appropriate, in the public interest, and consistent with the protection of investors to permit the listing and trading of security futures based on any security that is eligible to underlie an exchange-listed option because such security futures may facilitate price discovery in, and be a useful hedge for, the underlying securities, including certain unregistered debt securities.<sup>26</sup> Finally, the Commissions note that all security

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<sup>25</sup> 15 U.S.C. 78s(b).

<sup>26</sup> The listing standards applicable to options generally require, among other things, that the underlying security be registered under Section 12 of the Exchange Act, be an NMS Stock, as defined in Regulation NMS under the Exchange Act, 17 CFR 242.600(b)(47), and have a substantial number of outstanding shares that are widely held and actively traded. See, e. g., CBOE Rule 5.3 (Criteria for Underlying Securities). To date, the only securities not registered under Section 12 of the Exchange Act (other than U.S.

futures will continue to be required to meet the requirements of Sections 6(h)(3)(B), (C), and (E) – (L) of the Exchange Act<sup>27</sup> and Sections 2(a)(1)(D)(i)(II) and (IV) – (XI) of the CEA.<sup>28</sup>

Unless the Commissions jointly determine otherwise, some securities eligible to underlie options traded on a national securities exchange currently may not be eligible to underlie security futures because such securities may not be common stock or covered by the Prior Joint Orders. By permitting any security eligible to underlie options to also underlie security futures, the Commissions are modifying the listing standard requirements in the Exchange Act and the criteria in the CEA to eliminate the requirement that any security underlying security futures, including each component security of a narrow-based security index, be common stock or such other equity securities as the Commissions may jointly determine. Instead, as long as a security may underlie options traded on a national securities exchange and the listing standards and the criteria for futures on such security meet the requirements of Sections 6(h)(3)(B), (C), and (E) – (L) of the Exchange Act and Sections 2(a)(1)(D)(i)(II) and (IV) – (XI) of the CEA, such security may underlie security futures.<sup>29</sup>

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government securities) that the SEC has approved to underlie exchange-listed options are certain corporate debt securities. See Securities Exchange Act Release No. 55976 (June 28, 2007), 72 FR 37551 (July 10, 2007) (order approving a proposal by the CBOE to list options on certain unregistered corporate debt securities). Among other things, these corporate debt securities must have substantial trading volume, initial principal amount, and outstanding float; the issuer of the corporate debt security must have at least one class of equity security registered under Section 12(b) of the Exchange Act; and the issuer's equity securities must satisfy the exchange's criteria to underlie options. See CBOE Rule 5.3.12.

<sup>27</sup> 15 U.S.C. 78f(h)(3)(B), (C) and (E) – (L).

<sup>28</sup> 7 U.S.C. 2(a)(1)(D)(i)(II) and (IV) – (XI).

<sup>29</sup> The Commissions note that Section 6(h)(3)(C) of the Exchange Act, 15 U.S.C. 78f(h)(3)(C), which will continue to apply, requires that listing standards for security futures be no less restrictive than comparable listing standards for options traded on a national securities exchange or national securities association.

Further, Section 6(h)(2) of the Exchange Act<sup>30</sup> provides that a national securities exchange or a national securities association is permitted to trade only security futures that (A) conform with listing standards that the exchange or association files with the SEC under Section 19(b) of the Exchange Act, and (B) meet the criteria specified in Section 2(a)(1)(D)(i) of the CEA.<sup>31</sup> Such security futures listing standards must also meet the requirements specified in Section 6(h)(3) of the Exchange Act,<sup>32</sup> including the requirement that the listing standards for security futures be no less restrictive than comparable listing standards for options traded on a national securities exchange or a national securities association.<sup>33</sup> Before listing and trading security futures on any security eligible to underlie options traded on a national securities exchange, a national securities exchange or a national securities association must file with the SEC, pursuant to Section 19(b)(7) of the Exchange Act<sup>34</sup> and Rule 19b-7 thereunder,<sup>35</sup> a proposed rule change relating to its listing standards. An exchange or an association also must concurrently file its proposed listing standards with the CFTC pursuant to Section 19(b)(7)(B) of the Exchange Act.<sup>36</sup>

B. Security Futures Based on Unregistered Debt Securities

Section 6(h)(3)(A) of the Exchange Act<sup>37</sup> and Section 2(a)(1)(D)(i)(I) of the CEA<sup>38</sup> require that any security underlying security futures, including each component security of a

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<sup>30</sup> 15 U.S.C. 78f(h)(2).

<sup>31</sup> 7 U.S.C. 2(a)(1)(D)(i).

<sup>32</sup> 15 U.S.C. 78f(h)(3).

<sup>33</sup> See Section 6(h)(3)(C) of the Exchange Act, 15 U.S.C. 78f(h)(3)(C).

<sup>34</sup> 15 U.S.C. 78s(b)(7).

<sup>35</sup> 17 CFR 240.19b-7.

<sup>36</sup> 15 U.S.C. 78s(b)(7)(B).

<sup>37</sup> 15 U.S.C. 78f(h)(3)(A).

<sup>38</sup> 7 U.S.C. 2(a)(1)(D)(i)(I).

narrow-based security index, be registered pursuant to Section 12 of the Exchange Act. Thus, although options are permitted to be listed on unregistered debt securities under exchange listing standards,<sup>39</sup> such securities would not be permitted to underlie security futures without modifying this requirement. As stated above, Section 6(h)(4)(A) of the Exchange Act and Section 2(a)(1)(D)(v)(I) of the CEA provide that the Commissions by rule, regulation, or order, may jointly modify this requirement to the extent that the modification fosters the development of fair and orderly markets in security futures products, is necessary or appropriate in the public interest, and is consistent with the protection of investors.

Pursuant to this authority, the Commissions previously adopted SEC Rule 6h-2<sup>40</sup> and amended CEA Rule 41.21<sup>41</sup> to modify the statutory listing standards for security futures to permit the trading of security futures based on debt securities and indexes composed of certain debt securities.<sup>42</sup> These rules permit the listing and trading of new and potentially useful financial products. The Commissions similarly believe that modifying the statutory listing standards for security futures to permit, under certain conditions, the trading of security futures based on certain unregistered debt securities, and narrow-based indexes composed of such securities, will reduce impediments to the listing of security futures based on debt securities and serve the public interest by allowing the creation of potentially useful new financial instruments, thereby fostering the development of fair and orderly markets in security futures. The Commissions also believe it is appropriate, in the public interest, and consistent with the protection of investors to permit, subject to the conditions discussed below, the listing of such

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<sup>39</sup> See supra note 26.

<sup>40</sup> 17 CFR 240.6h-2.

<sup>41</sup> 17 CFR 41.21.

<sup>42</sup> See 2006 Rulemaking, supra note 8

security futures because they may facilitate price discovery in, and be a useful hedge for, debt securities.

An issuer of debt securities that are registered under Section 12 of the Exchange Act must provide comprehensive public information. This joint order may permit the listing and trading of security futures on debt securities that are not registered under Section 12 of the Exchange Act. However, because the Commissions believe that the public interest and the protection of investors is served by having information about the underlying debt securities and their issuers available, the Commissions are placing certain conditions on this order. In particular, as discussed below, this order is conditioned on an issuer of unregistered debt securities that underlie security futures being subject to the periodic reporting requirements of the Exchange Act. This condition is designed to ensure that information about the issuers and their securities is available to investors and futures traders.

More specifically, the listing and trading of security futures on unregistered debt would be permissible so long as the following four conditions are satisfied.<sup>43</sup> First, the offer and sale of the underlying debt securities must have been registered under the Securities Act of 1933 (“Securities Act”).<sup>44</sup> This condition is designed so that participants in the security futures market have access to the detailed disclosure in the Securities Act registration statement for the debt securities underlying these security futures.

Second, the issuer of such securities must have at least one class of equity securities registered under Section 12(b) of the Exchange Act.<sup>45</sup> The debt securities of a wholly-owned

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<sup>43</sup> These four conditions are consistent with the conditions in the NYSE Exemption, *supra* note 9.

<sup>44</sup> 15 U.S.C. 77a *et. seq.*

<sup>45</sup> 15 U.S.C. 781(b).

subsidiary of a parent company with at least one class of equity securities registered under Section 12(b) of the Exchange Act may also underlie a security future.<sup>46</sup> This condition is designed so that there is public availability of information about the issuer and the securities, even though the particular debt securities underlying the security future are not registered under Section 12 of the Exchange Act. Because any security registered under Section 12(b) is listed on a national securities exchange, this condition assures that a national securities exchange is responsible for monitoring the listed securities of the issuer of the debt securities underlying a security future and enforcing compliance by that issuer with comprehensive listing standards of the applicable national securities exchange.

Third, the transfer agent for the debt securities underlying the security future must be registered under Section 17A of the Exchange Act.<sup>47</sup> This condition is designed so that the transfer agents providing services to issuers of debt securities underlying security futures are subject to SEC oversight and the requirements of the Exchange Act, including Section 17A, and the rules thereunder. Fourth, the indenture for the unregistered debt securities underlying the security future must be qualified under the Trust Indenture Act of 1939 (“Trust Indenture Act”).<sup>48</sup> This condition is designed so that the specific protections afforded to debt holders under the Trust Indenture Act apply to debt securities that underlie security futures. The trust indenture for underlying debt securities registered under the Securities Act is qualified under the Trust Indenture Act at the time of registration of those underlying debt securities.

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<sup>46</sup> The terms “parent” and “wholly-owned” have the same meanings as in Rule 1-02 of SEC Regulation S-X, 17 CFR 210.1-02.

<sup>47</sup> 15 U.S.C. 78q-1.

<sup>48</sup> 15 U.S.C. 77aaa-77bbbb.

As a result, by modifying the listing standard requirements such that the debt securities need not be registered under Section 12 of the Exchange Act, provided that the conditions set forth above are satisfied, the Commissions are increasing the types of debt securities on which security futures may be based while preserving the requirement that information important in making investment and trading decisions is available.

## II. Conclusion

For the reasons discussed above, the Commissions by order are jointly modifying the requirement in Section 6(h)(3)(D) of the Exchange Act<sup>49</sup> and the criteria specified in Section 2(a)(1)(D)(i)(III) of the CEA<sup>50</sup> to permit any security to underlie a security future, provided such security is eligible to underlie options traded on a national securities exchange.

In addition, for the reasons discussed above, the Commissions by order are jointly modifying the requirement specified in Section 6(h)(3)(A) of the Exchange Act<sup>51</sup> and the criterion specified in Section 2(a)(1)(D)(i)(I) of the CEA<sup>52</sup> to permit an unregistered debt security, or a narrow-based index composed of unregistered debt securities, to underlie a security future if the following conditions are met:

(1) Each such security is a note, bond, debenture, or evidence of indebtedness that is not an equity security as defined in Section 3(a)(11) of the Exchange Act;<sup>53</sup>

(2) The issuer of each such security has registered the offer and sale of the security under the Securities Act;

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<sup>49</sup> 15 U.S.C. 78f(h)(3)(D).

<sup>50</sup> 7 U.S.C. 2(a)(1)(D)(i)(III).

<sup>51</sup> 15 U.S.C. 78f(h)(3)(A).

<sup>52</sup> 7 U.S.C. 2(a)(1)(D)(i)(I).

<sup>53</sup> 15 U.S.C. 78c(a)(11).

(3) The issuer of each such security, or the issuer's parent if the issuer is a wholly-owned subsidiary (as such terms are defined in Rule 1-02 of SEC Regulation S-X),<sup>54</sup> has at least one class of common or preferred equity security registered under Section 12(b) of the Exchange Act<sup>55</sup> and listed on a national securities exchange;

(4) The transfer agent of each such security is registered under Section 17A of the Exchange Act,<sup>56</sup> and

(5) The trust indenture for each such security has been qualified under the Trust Indenture Act of 1939.<sup>57</sup>

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<sup>54</sup> 17 CFR 210.1-02.

<sup>55</sup> 15 U.S.C. 78l(b).

<sup>56</sup> 15 U.S.C. 78q-1.

<sup>57</sup> 15 U.S.C. 77aaa-77bbbb.

Accordingly,

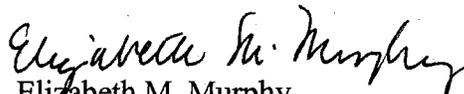
IT IS ORDERED, pursuant to Section 6(h)(4) of the Exchange Act and Section 2(a)(1)(D)(v)(I) of the CEA, that the requirements in Sections 6(h)(3)(A) and 6(h)(3)(D) of the Exchange Act and the criteria in Sections 2(a)(1)(D)(i)(I) and 2(a)(1)(D)(i)(III) of the CEA are modified, subject to the conditions set forth above, provided however, this order does not affect the CFTC's exclusive jurisdiction under Section 2(a)(1)(C) of the CEA over any futures contract based on an index that is not a "narrow-based security index," as defined in section 3(a)(55) of the Exchange Act and Section 1a(25) of the CEA. Accordingly, nothing in this order shall affect or limit the exclusive authority and jurisdiction of the CFTC with respect to any futures contract, now or in the future, including the CFTC's authority to approve any futures contract that is based upon an index that is not a "narrow-based security index."

By the Commodity Futures Trading Commission.<sup>58</sup>

David A. Stawick  
Secretary

November 19, 2009

By the Securities and Exchange Commission.

  
Elizabeth M. Murphy  
Secretary

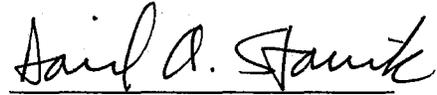
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<sup>58</sup> Because the Commissions are jointly modifying the listing requirements to permit security futures on any security that is eligible to underlie options contracts traded on a national securities exchange, this order supersedes and replaces the Prior Joint Orders. See supra notes 12 and 13.

**[THIS SIGNATURE PAGE RELATES TO THE COMMODITY FUTURES TRADING COMMISSION'S PORTION OF THE JOINT ORDER BY THE COMMODITY FUTURES TRADING COMMISSION AND THE SECURITIES AND EXCHANGE COMMISSION MODIFYING THE STATUTORY LISTING STANDARDS REQUIREMENTS TO PERMIT ANY SECURITY THAT IS ELIGIBLE TO UNDERLIE AN EXCHANGE-TRADED OPTION TO UNDERLIE SECURITY FUTURES.]**

By the Commodity Futures Trading Commission.

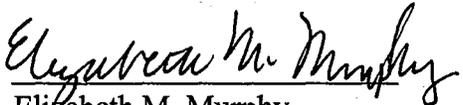
A handwritten signature in black ink, appearing to read "David A. Stawick". The signature is written in a cursive style with a horizontal line underneath it.

David A. Stawick  
Secretary

November 19, 2009

**[THIS SIGNATURE PAGE RELATES TO THE SECURITIES AND EXCHANGE COMMISSION'S PORTION OF THE JOINT ORDER BY THE COMMODITY FUTURES TRADING COMMISSION AND THE SECURITIES AND EXCHANGE COMMISSION MODIFYING THE LISTING STANDARDS REQUIREMENTS TO PERMIT ANY SECURITY THAT IS ELIGIBLE TO UNDERLIE AN EXCHANGE-TRADED OPTION TO UNDERLIE SECURITY FUTURES.]**

By the Securities and Exchange Commission.

  
Elizabeth M. Murphy  
Secretary

November 19, 2009