U.S. COMMODITY FUTURES TRADING COMMISSION
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OFFICE OF
GENERAL COUNSEL

July 23, 1996

96-54

Derek Oliver
Director of Legal Affairs
OMLX, The London Securities and Derivatives
Exchange Limited
107 Cannon Street
London EC4N 5AD
United Kingdom

Re: OMLX, The London Securities and Derivatives Exchange Limited Request for No-Action Letter for Futures Contracts Based on the OMX Stock Index

Dear Mr. Oliver:

This is in response to letters and facsimiles dated from May 18, 1995 through May 22, 1996 requesting that the Office of the General Counsel issue a no-action letter allowing the OMLX, The London Securities and Derivatives Exchange Limited ("OMLX") futures contracts based on the OMX Stock Index ("OMX Index" or "Index") to be offered and sold in the United States.[1/]

We understand the facts to be as follows. The OMLX is a fully computerized exchange located in the United Kingdom and is a Recognised Investment Exchange. As such, the OMLX is supervised by the Securities and Investment Board ("SIB"), the chief regulator of the U.K. financial services industry, under the provisions of the Financial Services Act 1986. The OMLX is a wholly-owned subsidiary of OM Gruppen, a publicly quoted company listed on the Stockholm Stock Exchange ("SSE"). The OM Stockholm, a Swedish futures exchange, is also a wholly-owned subsidiary of OM Gruppen. Trading on the OMLX in the standardized futures contract based on the OMX Index began on December 15, 1989. In June 1994, trading in the OMLX OMX Index Flex futures contract began.

[1/] The request was submitted for the standardized futures contract based on the OMX Index and the OMX Index Flex futures contract. The OMX Index Flex futures contract allows the parties to such contract to determine the expiration date for the Flex futures contract as long as that date differs from that of a corresponding standardized contract which is listed for trading at the time that a Flex futures contract is executed.

The OMX Index is the proprietary interest of OM Gruppen which has granted OMLX and OM Stockholm the right to use the OMX Index in connection with the trading of futures and options contracts based on such Index on the respective exchanges. OM Stockholm acts as the Index Provider. OM Gruppen has appointed the independent Swedish company, Dextel Findata AB, to act as the Index Calculator for the OMX Index and to undertake to calculate the OMX Index in accordance with the rules of OMLX and OM Stockholm. OM Gruppen has appointed KPMG Bohlins AB, the Swedish arm of the international accounting practice, KPMG, as an independent Index Ombudsman responsible for supervising the action of the Index Calculator particularly with reference to adjustments in the composition of the OMX Index and verifying the expiration values.

The OMX Index was launched in Sweden in September, 1986. It is a capital-weighted index designed to reflect the development of the Swedish equity market. The OMX Index contains the 30 most liquid stocks traded on the SSE which represent approximately 70 percent of all trading on the SSE. The OMX Index represents 15 industry groups, the largest industry group being pharmaceutical which represents a little more than 24 percent of the Index. As of February 29, 1996, the highest weighted stocks in the Index, Astra A, constituted no more than 19.62 percent of the total weight of the Index. As of the same date, the top five highest weighted stocks accounted for no more than 51.86 percent of the total weight of the Index. The total capitalization of stocks in the OMX Index as of February 29, 1996 was $117 billion.

The OMX Index is calculated continuously on all Swedish Bank Days using automated data from the SSE. The Index is calculated by reference to the last paid price (last trade price) for each constituent stock of the Index. The OMX Index is disseminated throughout the world through major quote vendors every minute throughout the trading day and is published daily in a number of newspapers, including the Financial Times.

The value of the OMX Index futures contract is determined by multiplying the level of the Index by 100 Swedish Kronor. The futures contract provides for cash settlement. The final settlement price of the OMX Index futures contract is ratified on the Swedish Bank Day following the Expiration Date. The Expiration Date of a standardized futures contract typically is the fourth Friday of the contract month. The Expiration Date of a FLEX futures contract is the Swedish Bank Day agreed upon by the counterparties. The final settlement price is a special calculation of the OMX Index which is based, for each stock, on the aggregate value (in Swedish Kronor) of all transactions on the SSE on the futures' last trading day divided by the share volume that day. The last trading day is the Swedish Bank Day immediately preceding the Expiration Date.

The offer and sale in the United States of futures contracts traded on or subject to the rules of a foreign exchange is subject to the Commission's exclusive jurisdiction.[2/] Section 2(a)(1)(A), 7 U.S.C. § 2 (1994); 120 Cong. Rec. 34497 (1974) (statement of Senator Talmadge) (the terms "any other board of trade, exchange, or market" in Section 2(a)(1)(A)(i) make clear the Commission's exclusive jurisdiction includes futures contracts executed on a foreign board of trade, exchange or market).[3/] Section 2(a)(1)(B)(v) of the Act, 7 U.S.C. § 2a(v) (1994), generally prohibits any person from offering or selling a futures contract based on a securities index except as permitted under Section 2(a)(1)(B)(ii), 7 U.S.C. § 2a(ii) (1994). In turn, Section 2(a)(1)(B)(ii) sets forth three criteria to govern Commission designation of futures contracts in a group or index of securities:

(1) the contract must provide for cash settlement;

(2) the proposed contract must not be readily susceptible to manipulation nor to being used to manipulate any underlying security; and

(3) the index must be predominately composed of the securities of unaffiliated issuers and reflect the market for all publicly traded securities or a substantial segment thereof.

See H.R. Rep. No. 565, Part 1, 97th Cong., 2d Sess. 39 (1982).

Section 2(a)(1)(B)(ii) provides that the Commission shall not designate a board of trade as a contract market unless the Commission finds that the board of trade meets the enumerated criteria. As noted above, we understand that the OMLX does not seek designation as a contract market. However, Congress understood that a foreign exchange might lawfully offer futures

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[2/] Section 12(e) of the Commodity Exchange Act prohibits the application of any federal or state statute to a transaction that is conducted on or subject to the rules of a foreign exchange "except as otherwise specified by the Commission by rule or regulation." 7 U.S.C. § 16(e) (1994). The Commission has authorized the application of state law to "any person required to be registered under . . . [Part 30] who solicits foreign futures and foreign options customers and who shall fail or refuse to obtain such registration, unless such person is exempt from such registration . . . ." 17 C.F.R. § 30.11 (1995).

[3/] In this regard, pursuant to the authority in, among other provisions, Section 4(b) of the Act, 7 U.S.C. § 6(b) (1994), the Commission has promulgated rules to regulate the offer and sale in the United States of foreign futures and options contracts. See 17 C.F.R. Part 30 (1995).

contracts on stock indices absent designation. Thus, the House Committee on Agriculture suggested that a foreign board of trade could apply for "certification" that its stock index contract met all applicable Commission requirements. H.R. Rep. No. 565, Part 1, 97th Cong., 2d Sess. 85 (1982). The Commission has not established criteria for certification of foreign futures contracts. However, the House Committee on Agriculture explained that a foreign exchange seeking certification for a futures contract based upon an index of American securities must demonstrate that the proposed futures contract meets the requirements set forth in Section 2(a)(1)(B)(ii). Id.

We understand that the securities in the OMX Index are issued by Swedish companies. The House Committee suggests that the Commission may use such criteria as it deems appropriate in evaluating a foreign stock index contract based on "foreign securities." Id. The requirements of Section 2(a)(1)(B)(ii) of the Act were designed to permit innovative financial instruments "while at the same time [assuring] that futures trading is limited to broad-based . . . indices that are not conducive to manipulation or disruption of the market for the underlying securities." S. Rep. No. 390, 97th Cong., 2d Sess. 6 (1982). See also H.R. Rep. No. 565, Part 1, 97th Cong., 2d Sess. at 39. As a result, we would recommend that the Commission use the criteria set forth in Section 2(a)(1)(B)(ii) in establishing any certification procedures for the OMLX OMX Stock Index futures contract. Accordingly, the staff has examined the OMLX OMX Stock Index futures contract in light of these criteria.[4/]

Based on the information set forth above, this Office will not recommend any enforcement action to the Commission based on Sections 2(a)(1)(B)(v), 4(a), or 12(e) of the Commodity Exchange Act, as amended, if the OMX Index and OMX Index Flex futures

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[4/] We also have sought the opinion of the staff of the Securities and Exchange Commission ("SEC") which informs us that they would have no objection to the offer and sale of this futures contract in the United States. In its letter dated June 26, 1996, the SEC noted its agreement with the OMLX under which the OMLX has agreed to contact the Division of Market Regulation ("Division") should the average weighting of any single issuer in a calendar month exceed 25 percent of the Index, or if the combined average weightings of the top three issuers account for more than 50 percent of the Index. Moreover, if the average weighting of any single issuer during a calendar quarter should exceed 30 percent, or if the combined average weightings of the top three issuers represent more than 55 percent of the Index, the OMLX will promptly suspend further offers or sales of futures contracts on the Index in reliance on the CFTC's no-action letter unless the Division staff advises the OMLX that it has waived or modified this condition.

contracts traded on the OMLX are offered and sold in the United States. Because this position is based upon facts and representations contained in the above-noted letters, facsimiles, and attachments, it should be noted that any different, omitted or changed facts or conditions might require a different conclusion.[5/] This position also is contingent on the continued compliance by the OMLX with all regulatory requirements imposed by the SIB and the applicable statutes of the United Kingdom.

As you are aware, the Commission has adopted rules governing the offer and sale of foreign futures and foreign option contracts in the United States. See 17 C.F.R. Part 30. The offer and sale

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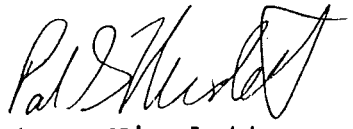
[5/] The OMLX has represented that it is willing and able to share information of a regulatory nature in relation to the OMX Index futures contracts with the Commodity Futures Trading Commission. See Letter dated May 18, 1995 to Elisse B. Walter, CFTC, from Derek Oliver, OMLX. Moreover, the Commission has executed a Memorandum of Understanding with the SIB. See Memorandum of Understanding on Mutual Assistance and the Exchange of Information Between the United States Securities and Exchange Commission and the Commodity Futures Trading Commission and the United Kingdom Department of Trade and Industry and Securities and Investment Board dated September 25, 1991. Finally, on March 15, 1996, the CFTC and the U.K. SIB were two of the signatories to the Declaration on Cooperation and Supervision of International Futures Exchanges and Clearing Organizations for the sharing of large exposure information.

In evaluating requests for no-action relief with regard to foreign futures contracts based on foreign stock indices, this Office generally examines whether a surveillance sharing arrangement exists between the futures exchange and the securities exchange on which the underlying stocks are traded. In this regard, the OM Stockholm has a market supervision arrangement with the SSE which covers broad surveillance and information sharing arrangements. The OMLX has noted that it is a fellow subsidiary of OM Gruppen and that its existing arrangement with OM Stockholm would ensure that it is informed of any relevant information provided to OM Stockholm by the SSE and further, that the OMLX would be able to request particular information from the SSE through OM Stockholm. See December 18, 1995 letter to David R. Merrill, CFTC, from Derek Oliver, OMLX.

in the United States of the OMLX OMX Index and OMX Index Flex futures contracts is, of course, governed by these regulations.

Sincerely,



Pat G. Nicolette
Acting General Counsel

cc: Robert Colby
Deputy Director
Division of Market Regulation
Securities and Exchange Commission