



U.S. COMMODITY FUTURES TRADING COMMISSION

Three Lafayette Centre
1155 21st Street, NW, Washington, DC 20581
Telephone: (202) 418-5120
Facsimile: (202) 418-5524

Office of General Counsel

CFTC Letter No. 08-19
November 26, 2008
No-Action
Office of General Counsel

Kathryn M. Trkla, Esq.
Foley & Lardner LLP
321 North Clark Street, Suite 2800
Chicago, IL 60610-4764

Re: Thailand Futures Exchange Pcl's Request for No-Action Relief in Connection with the Offer and Sale in the United States of its Futures Contract Based on the SET50 Index Futures Contract

Dear Ms. Trkla:

This is in response to your letters, attachments, facsimiles and electronic mail dated from February 23, 2007 to April 30, 2008, requesting on behalf of the Thailand Futures Exchange Pcl ("TFEX"), 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 TFEX's futures contract based on the SET50 Index ("SET50" or "Index").

We understand the facts to be as follows. TFEX was established on May 17, 2004 as a subsidiary of the Stock Exchange of Thailand ("SET"). It was formed to be the primary centralized marketplace in Thailand for financial and non-agricultural derivatives. All trading on TFEX occurs electronically through an integrated trading and clearing platform. TFEX is subject to regulation under the Thailand Derivatives Act, B.E. 2546, which is administered by the Thailand Securities and Exchange Commission ("Thailand SEC"). The Thailand SEC approved TFEX's license to operate as a derivatives exchange on February 11, 2005. Subject to the Thailand SEC's oversight, TFEX is required to have effective market surveillance and trade practice surveillance programs in place.¹

¹ See letter from Kathryn M. Trkla, Foley & Lardner LLP, to Nanette R. Everson, General Counsel, CFTC, dated February 23, 2007, at 1, 7. In addition, TFEX's rules and contracts are subject to approval by the Thailand SEC. In order to obtain approval for a contract, TFEX must demonstrate to the Thailand SEC that the contract can be used for hedging and price discovery and meets other standards. In reviewing a contract submission, the Thailand SEC, among other things, considers the potential price impact of the contract on the underlying cash market, cash market liquidity, the prevention of price manipulation and, for a cash-settled contract, the integrity of the cash settlement price calculations. The Thailand SEC determined that the SET50

The SET50 is a broad-based, free-float, market-capitalization-weighted, composite index of 50 of the most highly capitalized and liquid stocks currently listed for trading on the SET. Created by the SET in 1995, the SET50 is designed to represent the overall performance of the Thai stock market. To be eligible for inclusion in the Index, stocks must have been listed on the SET for at least six months and rank among the top 200 stocks in terms of market capitalization.²

After eligible stocks have been identified, the top 50 stocks in terms of average daily market capitalization are chosen for inclusion in the SET50.³ Based on data supplied by TFEX, the total adjusted market capitalization of the stocks in the SET50 was US\$ 137.90 billion as of February

futures contract meets the applicable standards and approved the contract for trading on February 22, 2006. *Id.* at 7-8.

² In addition, the monthly turnover value of the stock must be more than 50% of the total average turnover value per stock for the top 200 stocks listed on the SET in the same month for at least 9 of the 12 months in the evaluation period. Stocks also must maintain their share distribution or free-float qualification so that ordinary shareholders hold not less than 20% of the capital in the company. Stocks that have been listed for trading for over 6 months, but less than 12 months, must have been in the top 200 in terms of market capitalization for the entire time that they were so listed. A stock is not eligible for inclusion in the Index if it is being delisted due to the regulations of the SET, the stock is being voluntarily delisted, or trading has been suspended or might be suspended for an extended period of time. *See* letter from Kathryn M. Trkla, Foley & Lardner LLP, to Julian E. Hammar, Assistant General Counsel, CFTC, dated February 25, 2008, Appendix F.

³ *Id.* The SET reviews the Index bi-annually in June and December, and the list of new stocks is made available as soon as it has been determined during the evaluation month. The new composition takes effect beginning on the first business day in January and July. If necessary, ongoing revisions to the Index may occur. If a stock is removed from the Index, it is replaced with another stock from those ranked 51 through 55 in terms of average daily market capitalization. Changes are made to the Index when the market value of a component stock changes for non-market-related reasons, *e.g.* due to conversion of convertible stocks, exercising of warrants, issuing of new shares, etc. If a constituent company merges with another company (constituent or non-constituent) and the free-float proportion of the new company's shares is at least 20%, then the new company will be included in the Index after the close of business on the first trading day after the merger. If the merger is between two constituent companies, the resulting vacancy will be filled with a non-constituent company on the replacement list. The SET announces the new Index constituents as soon as possible following the merger.

Under Section 99 of the Thailand Derivatives Act, it is unlawful for directors, employees, agents or any person working for the stock exchange, stock clearinghouse, derivatives exchange or derivatives clearinghouse who has possession of material, non-public information to engage in a derivatives transaction or offer to sell a derivatives transaction in connection with such information for his own benefit or the benefit of others, or to disclose such information to another person when he knows or should have known that such person may take advantage of such information by engaging in a derivatives transaction. *See* letter from Ms. Trkla to Ms. Everson, dated February 23, 2007, Appendix I.

5, 2008.⁴ The largest single security by weight represented about 19.59%, and the five largest securities by weight represented about 46.52%, of the SET50.⁵ The securities comprising the lowest 25% of the SET50 had an aggregate value of average daily trading volume of about US\$ 73 million over the six-month period ending February 5, 2008.⁶ The SET50 is calculated in real time and disseminated by electronic means through major data vendors.⁷

TFEX's futures contract on the SET50 began trading on April 28, 2006. The futures contract provides for cash settlement. Prices are quoted in Index points with each Index point equal to Bhat 1,000 per contract. The minimum price fluctuation is one-tenth of one Index point. TFEX currently lists for trading the nearest four months of the March quarterly cycle. The contract is subject to a position limit of 10,000 contracts in any contract month or all months combined. The last trading day is the business day immediately prior to the last business day of the contract month. The final settlement price is determined by taking the values of the SET50 at one-minute intervals from 4:01 p.m. to 4:30 p.m. on the last trading day, discarding the three highest and three lowest observations, and calculating the simple average of the remaining 24 values rounded to two decimal places.⁸

The Commodity Exchange Act ("CEA"),⁹ as amended by the Commodity Futures Modernization Act of 2000 ("CFMA"),¹⁰ 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,¹¹ with the exception of security futures products,¹² over which the Commission shares jurisdiction with the Securities and Exchange Commission ("SEC").¹³ Thus, the Commission's jurisdiction

⁴ See letter from Ms. Trkla to Mr. Hammar, dated February 25, 2008, at 2 and Appendix C.

⁵ *Id.* at 3 and Appendix C.

⁶ *Id.* and Appendix H.

⁷ See letter from Ms. Trkla to Ms. Everson, dated February 23, 2007 at 3.

⁸ *Id.* Appendix A (Procedures).

⁹ 7 U.S.C. § 1 *et seq.*

¹⁰ Appendix E of Pub. L. No. 106-554, 114 Stat. 2763 (2000).

¹¹ See CEA Section 2(a)(1)(C)(ii).

¹² 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).

¹³ See CEA Section 2(a)(1)(D).

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).¹⁴

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).¹⁵ 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.¹⁶

While 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

¹⁴ See CEA Section 2(a)(1)(C)(ii).

¹⁵ CEA Section 2(a)(1)(D) governs the offer and sale of security futures products.

¹⁶ 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).

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.¹⁷

Accordingly, Commission staff has examined the SET50 and TFEX'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 letter, attachments, facsimiles and electronic mail cited above, we have determined that the SET50, and TFEX's futures contract based thereon, conform to these requirements.¹⁸

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 SET 50 are traded on the SET, TFEX's parent company. TFEX represents that, because it is a subsidiary of the SET, the two exchanges share relevant information with one another as necessary and appropriate to perform their respective market surveillance responsibilities.¹⁹ Accordingly, TFEX should have access to information with respect to the securities underlying the SET50 necessary to detect and deter manipulation. In the event that TFEX is unable to obtain access to adequate surveillance data in this regard, or is unable, either directly or through the Thailand SEC, to share such data with the CFTC, this Office reserves the right to reconsider the position we have taken herein.²⁰

¹⁷ 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.

¹⁸ In making this determination, Commission staff has concluded that the SET50 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.

¹⁹ See letter from Ms. Trkla to Ms. Everson, dated February 23, 2007, at 5.

²⁰ TFEX has confirmed that it will share information with the Commission upon request, either directly or indirectly through the Thailand SEC, to the extent permitted under the Thailand Derivatives Act. See letter from Ms. Trkla to Ms. Everson, dated February 23, 2007, at 6. In this regard, TFEX may share non-client information directly with the Commission. Client information, however, may only be shared through the Thailand SEC. Such information may be shared through the Multilateral Memorandum of Understanding Concerning Consultation and Cooperation and the Exchange of Information of the International Organization of Securities Commissions (“IOSCO MOU”), to which the Thailand SEC and the Commission are signatories.

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 TFEX's futures contract based on the SET50 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 TFEX with all regulatory requirements imposed by the Thailand SEC, and the applicable laws and regulations of Thailand. 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 TFEX's futures contract on the SET50 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.²¹

Sincerely,

Terry S. Arbit
General Counsel

The IOSCO MOU is a multilateral mechanism for sharing surveillance 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.

²¹ See 17 C.F.R. Part 30.