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Commodity Exchange Act Section 2(a)(1)(C)(ii) and (iv), and CFTC Rule 30.13

September 6, 2022

Vincent McGonagle
Director
Division of Market Oversight
Commodity Futures Trading Commission
1155 21st Street N.W.
Washington, D.C. 20581

Re: Request for No-Action Relief under Section 2(a)(1)(C)(ii) and (iv) of the Commodity Exchange Act ("**CEA**" or the "**Act**") and CFTC Rule 30.13.

Dear Mr. McGonagle:

The Korea Exchange ("**KRX**") is writing to request assurance in accordance with the requirements of Commodity Futures Trading Commission ("**CFTC**" or "**Commission**") Rule 140.99 that the Division of Market Oversight (the "**Division**") will not recommend that the Commission commence an enforcement action against KRX with respect to the offer or sale to, or trading by, U.S. persons that are qualified institutional buyers ("**QIBs**")[1] of the KOSPI 200 Futures contract months or Mini KOSPI 200 Futures contract months newly listed on the KRX on and/or from October 24, 2022,[2] and contract months without open interest that were listed prior to October 24, 2022. The requested relief would be effective from October 24, 2022 during the pendency of the Division's review of a submission to the Commission by KRX of a request for expedited review and notice of certification by the CFTC of the KOSPI 200 Futures contracts and KOSPI 200 Mini Futures contracts (the **"Contracts"**) as non-narrow based index futures contracts pursuant to CFTC Rule 30.13(e).

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[1] As defined in Rule 144A under the Securities Act of 1933.

[2] The conclusion of the three-month transition period set forth in CFTC Rule 41.14 is October 21, 2022. Because the next business day is October 24, 2022, we have based our request on this date.

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I. FACTUAL BACKGROUND

A. KRX

KRX, headquartered in Busan, Republic of Korea, is the sole securities and derivatives exchange operating in the Republic of Korea. KRX was formed as a result of the merger of the Korea Stock Exchange, the Korea Securities Dealers Automated Quotations Securities Exchange and the Korea Futures Exchange on January 27, 2005. The three formerly independent exchanges are now divisions of KRX. The KRX Derivatives Market, a separate market from the equity markets offers investors futures and options on several classes of assets across equities, currencies, interest rates, commodities and exchange-traded funds. There are 26 products listed on the KRX Derivatives Market, including the KOSPI 200 Futures contracts and the Mini KOSPI 200 Futures contracts. KRX is one of the leading derivatives marketplaces in Asia with abundant liquidity.

KRX serves as the central counterparty to exchange-traded securities and derivatives products that KRX offers. Aside from exchange-traded products, KRX also serves as the central counterparty for certain over-the-counter derivatives.

In 2016, KRX obtained an exemption from certain CFTC foreign futures and options regulations, including relief for its member firms from compliance with futures commission merchant ("**FCM**") registration requirements, under CFTC Rule 30.10. Pursuant to the relief, U.S. persons may access the index futures contracts offered by KRX through a member firm that is permitted to rely on the CFTC Rule 30.10 relief. In addition, U.S. persons may access the index futures contracts offered by KRX through the customer omnibus account of a U.S. registered FCM carried on the books of KRX member firms.

B. The KOSPI 200 Index

The KOSPI 200 Index underlies the Contracts, which satisfy the requirements for non-narrow based stock indices set forth in Section 2(a)(1)(C)(ii) of the CEA and Appendix D to Part 30 of the CFTC's Regulations because: (1) the Contracts are cash settled; (2) the Contracts are not readily susceptible to manipulation or to being used to manipulate any underlying security; (3) the index of securities underlying the Contracts is not a narrow-based security index; and (4) the index has more than 10 component securities.

KRX previously certified to the CFTC non-narrow based security index futures contracts on the KOSPI 200 Index.[3] However, during May 2022, this index became recharacterized as a narrow-

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[3] CFTC No-Action Letter No. 08-20 (Nov. 26, 2008), https://www.cftc.gov/sites/default/files/idc/groups/public/@lrlettergeneral/documents/letter/08-20.pdf. However, since 2020, the KOSPI 200 Index has been recharacterized several times. When the KOSPI 200 Index became recharacterized as a narrow-based security index in April 2020, the CFTC decertified the Contracts and KRX complied with requirements applicable to security futures subject to joint CFTC and SEC oversight. The KOSPI 200 Index was recharacterized as a broad-based security index in December 2021, and KRX certified to the CFTC the Contracts. Letter from Meghan Tente, Acting Director, CFTC

based security index due to the weight in the index of the largest component of the KOSPI 200 Index exceeding 30%. As a result, the Contracts became security futures contracts subject to the joint jurisdiction and regulation of the CFTC and U.S. Securities and Exchange Commission ("**SEC**"). Since that time only U.S. Persons that are QIBs may trade in the Contracts pursuant to the terms of an SEC Order[4] and related CFTC Advisory[5] relating to foreign security futures. Based on its observations of the KOSPI 200 Index, KRX believes that the index is now poised to become a non-narrow based index once again.

II. APPLICABLE LAW

A. Definition of Broad-Based Security Index

The term "broad-based security index" means any index of securities that does not meet the definition of narrow-based security index as set forth in the Act and the Securities Exchange Act of 1934 ("**Securities Act**").[6] An index must not have any of the four characteristics of the narrow-based security index definition to be considered a broad-based security index. Accordingly, to qualify as a broad-based security index, the underlying index must satisfy all of the following criteria: (1) have at least 10 component securities; (2) no component of the index can comprise 30% or more of the index weighting; (3) the five highest weighted components of the index cannot comprise more than 60% of the index weighting; and (4) the lowest weighted components comprising the aggregate 25% of the index weighting must have an aggregate dollar value over a

Division of Market Oversight, to Hyojae Cho, President, Derivatives Market Division, KRX (Jan. 18, 2022). During the pendency of the CFTC's review of the certification, KRX continued to offer the Contracts to U.S. persons that were QIBs pursuant to the no-action relief that the Division granted to KRX. CFTC No-Action Letter No. 21-25 (Nov. 23, 2021), https://www.cftc.gov/csl/21-25/download. The CFTC decertified the Contracts when the KOSPI 200 Index reverted to a narrow-based security index in May 2022 and KRX again complied with requirements applicable to security futures subject to joint CFTC and SEC oversight. Now, KRX seeks to certify the Contracts when the transition period concludes and, while the certification is under CFTC review, rely on the relief requested herein, similar to the relief that the Division granted in 2021.

[4] Order under Section 36 of the Securities Exchange Act of 1934 Granting an Exemption from Exchange Act Section 6(h)(1) for Certain Persons Effecting Transactions in Foreign Security Futures and under Exchange Act Section 15(a)(2) and Section 36 Granting Exemptions from Exchange Act Section 15(a)(1) and Certain Other Requirements, Release No. 34-60194; International Series Release No. 1311 (Jun. 30, 2009) (the "**SEC Order**").

[5] Division of Clearing and Intermediary Oversight (DCIO) Advisory Concerning the Offer and Sale of Foreign Security Futures Products to Customers Located in the U.S. (Jun. 8, 2010) (the "**CFTC Advisory**").

[6] Pursuant to the CEA and the Securities Act, a narrow-based security index is defined as an index of securities that meets any one of the following four requirements: (1) it has nine or fewer components; (2) one component comprises more than 30 percent of the index weighting; (3) the five highest weighted components comprise more than 60 percent of the index weighting; or (4) the lowest weighted components comprising in the aggregate 25 percent of the index's weighting have an aggregate dollar value of average daily volume over a six-month period of less than $50 million ($30 million if there are at least 15 component securities). Section 1a(35)(A) of the Act and Section 3(a)(55)(B) of the Securities Exchange Act of 1934; 7 U.S.C. § 1a(35)(A) and 15 U.S.C. § 78c(a)(55)(A).

six-month period of over $50 million, or over $30 million if there are at least 15 component securities.

B. CFTC Jurisdiction Over Broad-Based Indices

Under Section 2(a)(1)(C)(ii) of the CEA, the Commission has exclusive jurisdiction over futures on broad-based security index contracts, including the offer and sale of foreign listed contracts to U.S. persons. Unlike other foreign futures and options contracts, which are not required to be formally approved by the CFTC before they may be offered and sold to U.S. persons, the CFTC must certify a broad-based security index futures contracts before such contracts may be offered or sold to U.S. persons.[7]

C. Characterization of the KOSPI 200 Index

KRX previously certified to the CFTC broad-based security index futures contracts on the KOSPI 200 Index.[8] However, during April 2020, the index became recharacterized as a narrow-based security index. During December 2021, the index became recharacterized as a broad-based security index, but shortly thereafter it became recharacterized as a narrow-based security index in May 2022. As a result, the futures contracts on the KOSPI 200 Index became a security futures contract subject to the joint jurisdiction and regulation of the CFTC and SEC. Upon its review of the characteristics of the index KRX has determined that the index will qualify as a broad-based index after the conclusion of the three-month transition period set forth in CFTC Rule 41.14 on October 21, 2022.[9]

D. CFTC Index Transition Period

In 2001, the CFTC and the SEC (together, the "**Commissions**") jointly issued final rules setting forth the requirements for an index underlying a futures contract to be excluded from the definition of "narrow-based security index", among other rules.[10] Because the composition of stock indexes can evolve over time, the rules provide for a three-month transition period for futures contracts whose underlying index changes from narrow-based to broad-based, with the specific goals of minimizing market disruption and providing certainty to market participants as to the applicable

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[7] Section 2(a)(1)(C)(iv) of the Act; 7 U.S.C. § 2(a)(1)(C)(iv).

[8] *See supra, n.3.*

[9] CFTC Rule 41.14(b) ("Transition period for indexes that cease being narrow-based security indexes for more than forty-five days. An index that is a narrow-based security index that becomes a broad-based security index for more than 45 business days over 3 consecutive calendar months shall continue to be a narrow-based security index for the following 3 calendar months.").

[10] *See* Method for Determining Market Capitalization and Dollar Value of Average Daily Trading Volume; Application of the Definition of Narrow-Based Security Index; Joint Final Rule, 66 Fed. Reg. 44,490 (adopted Aug. 23, 2001).

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regulatory regime. CFTC Rule 41.14 specifies a three-month transition period for indexes that cease being narrow-based security indexes.[11]

E. Guidance Related to the Transition Period

The adopting release to the final rules acknowledges that the transition from a narrow-based index to a broad-based index has the potential to disrupt the market, particularly in light of the change in the regulatory regime.[12] The CFTC noted that the three-month transition period "will provide certainty to the market and investors that the index has indeed become broad-based, and is not in the midst of more fluctuation."[13] Moreover, the transition period will prevent market participants that trade in a futures contract with an underlying index that switches from narrow-based to broad-based "from being taken by surprise" when the regulatory regime changes.[14] Thus, one of the goals of the three-month transition period is to provide certainty for traders so that they know when trading in a certain contract will come to an end or when a new regulatory regime begins to govern.[15] In consideration of the potential market disruption that could occur when a futures contract's underlying index changes from narrow-based to broad-based, the CFTC determined to permit markets to continue trading futures contracts when the underlying index has become broad-based without restricting trading to liquidating trades.[16]

In the proposing release the Commissions noted that one of the purposes of the CFTC Rule 41.14 three-month transition period is to provide time for an exchange to come into compliance with CFTC requirements. The Commissions stated that an exchange would need "to take such action as may be necessary to trade the index as a broad-based index subject to the sole jurisdiction of the CFTC" if the exchange intended to trade an index after the transition period.[17] The Commissions reiterated this purpose in the adopting release, and the CFTC further noted that it would provide a "no-action" position for an exchange trading a narrow-based security index futures contracts that became recharacterized as a broad-based security index futures contracts provided that the exchange administers the contracts in accordance with Rule 41.14.[18] The CFTC

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11 CFTC Rule 41.14(b) ("An index that is a narrow-based security index that becomes a broad-based security index for more than 45 business days over 3 consecutive calendar months shall continue to be a narrow-based security index for the following 3 calendar months.").

12 *See* 66 Fed. Reg. at 44,503.

13 *Id.*

14 *Id.*

15 *Id.*

16 *Id.*

17 Method for Determining Market Capitalization and Dollar Value of Average Daily Trading Volume; Application of the Definition of Narrow-Based Security Index, 66 Fed. Reg. 27,560, 27,568 (proposed May 17, 2001).

18 66 Fed. Reg. at 44,503.

explained that it would not take enforcement action for violations of the Act when an exchange "is in the midst of the 45-day tolerance provision of paragraph (a), the three-month grace period of paragraph (b), or the unwinding period of paragraph (c)."[19]

The SEC did not adopt a parallel rule to CFTC Rule 41.14 and said that it was not authorized to adopt such a rule "because the SEC has no jurisdiction over broad-based security index futures."[20] Thus, the operation and administration of the transition from a narrow-based to broad-based index is solely within the purview of the CFTC. When the index became recharacterized as a broad-based security index in December 2021, the Division issued no-action relief similar to the relief requested herein, permitting KRX to provide for the offer or sale of the Contracts to persons located within the United States while the Commission's review of KRX's request for certification of the Contracts pursuant to CFTC Rule 30.13 was pending.[21]

III. NEED FOR NO-ACTION RELIEF

After closely monitoring the KOSPI 200 Index during the past two years, KRX has determined that the index will qualify as a non-narrow based index after the conclusion of the three-month transition period on October 21, 2022. Pursuant to the provisions of CFTC Rule 41.14(c), U.S. persons (that are QIBs) may, after the transition period, continue to trade contract months in KOSPI 200 Futures contracts and Mini KOSPI 200 Futures contracts with open interest that were listed prior to October 24, 2022. However, new contract months in the KOSPI 200 Futures and Mini KOSPI 200 Futures (listed on or after October 24, 2022), which would be non-narrow-based futures contracts subject to the sole U.S. jurisdiction of the CFTC, and contract months without open interest that were listed prior to October 24, 2022, may not be offered or sold to any U.S. persons, including QIBs, absent certification of the contracts pursuant to CFTC Rule 30.13 or relief from the CFTC.

KRX understands that Division Staff believe that the language of the index transition rules may not support the approach of submitting a request for certification during the three-month index transition period, and therefore advised KRX that Staff may not be able to act on a request to certify the futures contracts based on the KOSPI 200 Index that is submitted before October 24, 2022. Based on that guidance and the prior precedent involving the transition of the index at the end of 2021 KRX is submitting this request for no-action relief to avoid the potential market disruption that could occur on October 24, 2022 if new contract months of the Contracts and contract months without open interest that were listed prior to October 24, 2022 could not be offered or sold to U.S. persons that are QIBs. Through the no-action relief KRX also wishes to provide regulatory certainty to market intermediaries and U.S. persons (QIBs) regarding their

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[19] *Id.*

[20] *Id.* at 44,504.

[21] CFTC No-Action Letter No. 21-25 (Nov. 23, 2021), https://www.cftc.gov/csl/21-25/download.

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ability to access all KOSPI 200 Futures contract months and Mini KOSPI 200 Futures contracts (i.e., all contract months listed before and after October 24, 2022) following October 24, 2022.

IV. RELIEF REQUESTED

We respectfully request the following relief (which is consistent with the relief granted in CFTC No-Action Letter No. 21-25 (Nov. 23, 2021):

- Effective October 24, 2022 (Korea time), all KOSPI 200 Futures contracts and Mini KOSPI 200 Futures contracts (regardless of contract month, including all contract months listed before or after October 24, 2022) may be offered or sold to U.S. persons that are QIBs.

- KRX would submit its request for expedited review and certification to the CFTC pursuant to CFTC Rule 30.13(e) on or around October 24, 2022. KRX will promptly respond to Division or Commission requests for additional information regarding the Contracts.

- KRX will abide by all provisions of CFTC Rule 30.13 during the pendency of its requests for certification, including, but not limited to, informing Division Staff of any changes in the material facts and representations provided in the request for certification pursuant to CFTC Rule 30.13(l).

- The relief would expire upon the earlier of: (a) the CFTC issuing a notice of certification of the KOSPI 200 Futures contracts and the Mini KOSPI 200 Futures contracts as being based on a non-narrow based index (which certification would allow the offer and sale of KOSPI 200 Futures contracts and Mini KOSPI 200 Futures contracts to all U.S. persons (not just QIBs)); (b) a determination by the Commission to terminate its review of or deny the request for certification of the Contracts pursuant to CFTC Rule 30.13; and (c) November 24, 2023 (Korea time).

V. CONCLUSION

We believe that providing the requested no-action relief under the circumstances described above is consistent with the established principles of the Commission with respect to the transition of indexes. The Commissions adopted the index transition rules with the goal of minimizing market disruption and providing regulatory certainty to market participants that trade futures contracts with an underlying index that converts from a narrow-based index to a broad-based index. That is precisely what KRX wishes to accomplish through the requested no-action relief.

Currently, U.S. market participants who are QIBs are permitted to trade the existing narrow-based index futures under the SEC Order and related CFTC Advisory. If, on October 24th (after the transition period has concluded), there is no broad-based index certification or no-action relief in effect, all U.S. market participants, including QIBs, would be restricted in their trading of newly listed Contracts and Contracts without open interest that were listed prior to October 24, 2022. The absence of CFTC certification or no-action relief effective as of October 24, 2022 would be

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potentially very disruptive to the KRX derivatives and equity markets and would cut against the stated purpose of the index transition period.

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We appreciate your attention to this matter. Please do not hesitate to contact Kyungwha Noh at lujinghe@krx.co.kr and Cheolho Choi at hanira@krx.co.kr or our outside counsel, Michael Philipp at 312-324-1905 or Michael.philipp@morganlewis.com if you wish to discuss this request or require further information.

If for any reason the Division is considering declining to issue relief along the lines requested, we would ask that we be given the opportunity to further discuss this request with you at that time.

The undersigned hereby certifies that the material facts set forth above are true and complete to the best of his knowledge. If, at any time prior to the issuance of the requested no-action letter, any material representation made in this letter ceases to be true and complete, the undersigned will ensure that the Division Staff is informed promptly in writing of all materially changed facts and circumstances. If a material change in facts or circumstances related to this request for no-action relief should occur subsequent to issuance of a letter by Division Staff, the undersigned will ensure that Division Staff is informed promptly in writing of all materially changed facts or circumstances.

Very truly yours,

조효제

Hyojae Cho
President
Derivatives Market Division, Korea Exchange

cc:
Grey Tanzi, Division of Market Oversight
Michael Philipp, Morgan, Lewis & Bockius LLP