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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

December 13, 1995

Philip McBride Johnson, Esquire
Skadden, Arps, Slate, Meagher & Flom
1440 New York Avenue, N.W.
Washington, D.C. 20005-2107

Re: Singapore International Monetary Exchange Nikkei Stock Index 300 Futures Contract

Dear Mr. Johnson:

This is in response to your letters dated June 15, 1994, August 12, 1994, and December 1, 1995 requesting a no-action letter allowing the Singapore International Monetary Exchange, Limited ("Simex") futures contract based on the Nikkei Stock Index 300 ("Nikkei Index" or "Index") to be offered or sold in the United States.[1/]

We understand the facts to be as follows. The Simex is located in Singapore and has been in operation since September 1984. The Simex is regulated by the Monetary Authority of Singapore as a futures exchange under the Futures Trading Act of 1986. The Simex is not designated as a contract market under the Commodity Exchange Act ("CEA" or "Act") and does not intend to seek such designation.[2/]

The Nikkei Index was developed and is published by the Nihon Keizai Shimbun, Inc. ("NKS") of Japan. The Nikkei Index is a capitalization-weighted stock index which is calculated based on

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1/ As you are aware, the Office of the General Counsel issued a no-action letter to the Simex with respect to the futures contract based on the Nikkei Stock Average on December 5, 1986 and to the futures contract based on the Morgan Stanley Capital International Hong Kong Index on June 1, 1994.

2/ On August 28, 1984, the Commission approved certain rule changes of the Chicago Mercantile Exchange ("CME") to facilitate the Mutual Offset System ("MOS") between the CME and Simex whereby positions established on one exchange can be transferred to or liquidated on the other exchange. We understand that the futures contract on the Nikkei Index at this time will not be conducted through the MOS. Thus, this no-action position is not applicable to the trading of the Nikkei Index futures contract on the MOS.

the prices of 300 stocks traded on the First Section of the Tokyo Stock Exchange ("TSE").[3] The Nikkei Index consists of some of the most actively traded stocks on the TSE.[4] The stocks comprising the Nikkei Index represent a broad cross-section of the stocks listed on the TSE, with no single industry group accounting for more than 23.77 percent of the aggregate capitalization of the Nikkei Index as of the end of September 1993.[5] The highest priced stock in the Nikkei Index as of the end of December 1993, Mitsubishi Bank, constituted no more than 3.6 percent of the market capitalization of the Nikkei Index. The ten highest capitalized stocks in the Nikkei Index accounted for 26.6 percent of the total market capitalization of the Nikkei Index as of the end of December 1993. The total capitalization of the stocks included in the Nikkei Index equaled 215.171 billion yen as of the end of December 1993. A small number of the stocks comprising the Nikkei Index are publicly traded in the United States: nine of such stocks are traded on the New York Stock Exchange, two on the Pacific Stock Exchange, two on the Chicago Stock Exchange, and another twelve are traded through the National Association of Securities Dealers Automated Quotations ("NASDAQ").

The Nikkei Index is calculated by adding the market values of the Index's component stocks, which are derived by multiplying the price of each component stock by the number of shares outstanding (excluding those owned by the Japanese government), to arrive at the total aggregate capitalization of the 300 stocks. The total aggregate capitalization is then divided by the aggregate capitalization of the Nikkei Index on the base date of October 1, 1982, and the Index value is expressed by a percentage to two decimal places. In order to maintain the continuity of the Index, the base aggregate capitalization is adjusted from time to time so as to adequately reflect aggregate capital increases or reductions resulting from non-market factors such as rights offerings, public offerings, private placements, and mergers. The replacement of the component stocks is reviewed annually in early October.

The Quick Corp., a NKS subsidiary, calculates the Nikkei Index every minute. The Nikkei Index also is disseminated on a minute-to-minute basis to various financial markets and information centers throughout the world.

3/ The most actively traded stocks on the Tokyo Stock Exchange are listed in the "First Section" of that Exchange.

4/ The stocks in the Nikkei Index accounted for approximately 67.1 percent of the aggregate capitalization and 61 percent of the total trading volume of the stocks in the "First Section" as of the end of September 1993.

5/ The Nikkei Index represents more than 30 industry groups.

The Nikkei Index futures contract traded on the Simex is valued at 10,000 Japanese Yen times the value of the Nikkei Index. The futures contract provides for cash settlement. The futures contract has a temporary price limit equal to 7.5 percent above or below the previous day's settlement price and a second limit equal to 12.5 percent. The final settlement price of the contract is based upon the opening prices of each component issue in the Nikkei Index on the business day following the last trading day.

The offer and sale of futures contracts traded on or subject to the rules of a foreign exchange is subject to the Commission's exclusive jurisdiction.6/ Section 2(a)(1)(A), 7 U.S.C. § 2 (1988); 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.)7/ Section 2(a)(1)(B)(v) of the Act, 7 U.S.C. § 2a(v), 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) (1988). 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.

6/ 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) (1988). 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 (1994).

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

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 Simex does not seek designation as a contract market. However, Congress understood that a foreign exchange might lawfully offer futures 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 while the securities in the Nikkei Index are issued by Japanese companies, some of these securities are traded on United States securities exchanges or for quotation on NASDAQ. 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 Nikkei Index futures contract. Accordingly, the staff has examined the Simex Nikkei Index futures contract in light of these criteria.[8/]

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 Nikkei Index futures contract traded on the

[8/] We also have sought the opinion of the staff of the Securities and Exchange Commission which informs us that they would have no objection to the offer and sale of this futures contract in the United States.

Simex is offered and sold in the United States.[9/] Because this position is based upon facts and representations contained in the above-noted letters and attachments, it should be noted that any different, omitted or changed facts or conditions might require a different conclusion.[10/] This position also is contingent on the continued compliance by Simex with all regulatory requirements imposed by the Monetary Authority of Singapore and the applicable statutes of Singapore.

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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9/ This no-action position is applicable solely to the Simex futures contract based on the Nikkei Index and does not apply to any option contract based on such futures contract. See 17 C.F.R. § 30.3 (1994).

10/ The Simex has represented that it is both able and willing to cooperate through information sharing and other means in any Commission inquiry into the Nikkei Index futures contract on Simex. See August 12, 1994 letter from Philip McBride Johnson to Pat G. Nicolette, Acting General Counsel, Commodity Futures Trading Commission. Further, the Simex has an information sharing arrangement with the CFTC in conjunction with the relief given to Simex under CFTC rule 30.10.

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. While there is no surveillance sharing arrangement between the Simex and the Tokyo Stock Exchange with regard to the Nikkei Index futures contract, several counterbalancing factors provide this Office with sufficient assurances that necessary information will be available to detect potential manipulations. See February 7, 1995 letter from Brandon Becker, Director, Division of Market Regulation, Securities and Exchange Commission to Elisse B. Walter, General Counsel, Commodity Futures Trading Commission.

in the United States of the Simex Nikkei Index futures contract is, of course, governed by these regulations.

Sincerely,

Elisse B. Walter

Elisse B. Walter
General Counsel

cc: Brandon Becker
Director
Division of Market Regulation
Securities and Exchange Commission