U.S. COMMODITY FUTURES TRADING COMMISSION
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Office of General Counsel

CFTC letter No. 06-11
June 14, 2006
No-Action
Office of General Counsel

Mr. Bhaskar Rao
Manager - Legal
Bombay Stock Exchange Ltd.
Phiroze Jeejeebhoy Towers, 25th Floor
Dalal Street, Mumbai – 400 001
INDIA

Re: No-Action Request to Permit the Offer and Sale in the United States of the Bombay Stock Exchange Limited's Futures Contract based on the Bombay Stock Exchange Sensitive Index

Dear Mr. Rao:

This is in response to letters, attachments, facsimiles and electronic mail dated from September 15, 2000 to February 10, 2006, requesting 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 ("U.S.") of the Bombay Stock Exchange Limited's ("BSE's") futures contract based on the BSE Sensitive Index ("Sensex" or "Index").

We understand the facts to be as follows. Founded in 1875, the BSE is the oldest exchange in Asia.[1] The BSE obtained permanent recognition from the Government of India in 1956 under the Securities Contracts (Regulation) Act, 1956. Both securities and futures contracts are traded on the exchange. The BSE is regulated by the Securities and Exchange Board of India ("SEBI"), which was established by the Securities and Exchange Board of India Act, 1992 ("SEBI Act"). The SEBI is responsible for regulating securities and derivatives trading in India.[2]

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[1] *See* letter from Patricia N. Gillman, Schiff Hardin & Waite to C. Robert Paul, General Counsel, CFTC, dated September 15, 2000.

[2] As a result of amendments to the SEBI Act in October of 2002, the SEBI's powers were enhanced to check cases of insider trading, fraudulent and unfair trading practices and market manipulation in order to protect investors. Further information regarding the

The Sensex is a broad-based, free-float market capitalization-weighted index designed to reflect the overall performance of the Indian equity market. The Index, which is owned and managed by BSE, consists of 30 of the most highly capitalized and actively traded stocks currently listed on BSE. Based on data supplied by BSE, the total market capitalization of the Sensex was approximately U.S. $270.0 billion and the "free float" market capitalization was approximately U.S. $129.4 billion as of January 19, 2006.[3] Also as of that date, the largest single security by weight represented 10.8%, and the five most heavily weighted securities represented 39.88%, of the Sensex.[4] The securities comprising the lowest 25% of the Sensex had six-month aggregate dollar values of average daily trading volume in excess of U.S. $30 million: approximately U.S. $37.36 million for the 6-month period ending December 31, 2005.[5] The Sensex is calculated in real time and is disseminated by electronic means through major data vendors, such as Bloomberg and Reuters.[6]

BSE's futures contract on the Sensex provides for cash settlement in Indian rupees. The notional value of the futures contract is determined by multiplying the Index by 50 rupees. Prices are quoted in Index points, and the minimum price fluctuation is 0.05 Index point per contract. BSE lists three contract months for trading in a monthly cycle. The last trading day is typically the last Thursday of the contract month. Contracts are cash settled based on the final settlement price of the Index on the last trading day. The final settlement price is based on a special quotation of the Index using the weighted average price of all trades in the last 15 minutes of trading.[7]

The Commodity Exchange Act ("CEA"),[8] as amended by the Commodity Futures Modernization Act of 2000 ("CFMA"),[9] provides that the offer or sale in the U.S. of futures contracts based on a group or index of securities, including those contracts

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SEBI and the laws and regulations governing securities and derivatives trading in India can be found on the SEBI's website, <http://www.sebi.gov.in>.

[3] *See* electronic mail from Bhaskar Rao, Manager – Legal, BSE, to Julian E. Hammar, Counsel, CFTC, dated February 10, 2006.

[4] *Id.*

[5] Id.

[6] Id.

[7] If no trades occur during the last 15 minutes of trading, then the last transaction price is used. *See id.* and BSE's website at <www.bseindia.com>.

[8] 7 U.S.C. § 1 *et seq.*

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

traded on or subject to the rules of a foreign board of trade, is subject to the Commission's exclusive jurisdiction,[10] with the exception of security futures products,[11] over which the Commission shares jurisdiction with the Securities and Exchange Commission ("SEC").[12] Thus, the Commission's jurisdiction remains exclusive with regard to futures contracts on a group or index of securities that are broad-based pursuant to CEA Section 1a(25).[13]

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).[14] 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.[15]

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[10] *See* CEA Section 2(a)(1)(C)(ii).

[11] Security futures products are 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).

[12] *See* CEA Section 2(a)(1)(D).

[13] *See* CEA Section 2(a)(1)(C)(ii).

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

[15] 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

While Section 2(a)(1)(C)(ii) provides that no board of trade 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 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.[16]

Accordingly, this Office has examined the Sensex, and BSE'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 letters, attachments, facsimiles and electronic mail noted above, we have determined that the Sensex, and BSE's futures contract based thereon, conform to these requirements.[17]

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. All of the stocks underlying the Sensex are traded on the BSE. Although all of these stocks also are traded on other exchanges in India, the SEBI has created an Inter Exchange

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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).

[16] 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.

[17] In making this determination, Commission staff has concluded that the Sensex does not have any of the elements of a narrow-based security index as enumerated in CEA Section 1a(25)(A), and accordingly the Index would not be a narrow-based security index if traded on a designated contract market or DTEF.

Surveillance Group to facilitate inter-exchange surveillance and information sharing.[18] Thus, BSE should have access to information necessary to detect and deter manipulation. In the event that BSE is unable to obtain access to adequate surveillance data in this regard, or is unable to share such data, either directly or indirectly, with the CFTC, this Office reserves the right to reconsider the position we have taken herein.[19]

In light of the foregoing, this Office will not recommend any enforcement action to the Commission based on Sections 2(a)(1)(C)(iv), 4(a), or 12(e) of the CEA, as amended, if BSE's futures contract on the Sensex 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 BSE with all regulatory requirements imposed by the SEBI, and the applicable laws and regulations of India. 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.

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[18] *See* letter from Patricia N. Gillman, Schiff Hardin & Waite, to David R. Merrill, Deputy General Counsel, CFTC, dated December 8, 2000.

[19] In this regard, BSE has represented that it is able and willing to provide information as may be permissible under applicable Indian Law and judicial precedent regarding its futures contract on the Sensex to the CFTC upon request. *See* letter from Ms. Gillman to Mr. Merrill, dated December 8, 2000 at 11. On August 26, 2004, the BSE's regulator, the SEBI, mandated the use of a Uniform Member Client Agreement, which provides that client information be disclosed by members of exchanges in India as required under any applicable law or regulatory requirements. *See* electronic mail from Chetna Ghone, BSE to Julian E. Hammar, Counsel, CFTC, dated July 7, 2005.

The SEBI itself is a signatory to the International Organization of Securities Commission's Multilateral Memorandum of Understanding Concerning Consultation and Cooperation and the Exchange of Information ("IOSCO MOU"). The IOSCO MOU, to which the CFTC is also a signatory, 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. The SEBI and the CFTC also have signed a bilateral Memorandum of Understanding Regarding Futures Regulatory Cooperation, Consultation and the Provision of Technical Assistance on April 28, 2004. In addition, the SEBI entered into a bilateral Memorandum of Understanding Regarding Cooperation, Consultation and the Provision of Technical Assistance with the SEC on March 6, 1998.

The offer and sale in the U.S. of BSE's futures contract on the Sensex 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.[20]

Sincerely,

Nanette R. Everson
General Counsel

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[20] *See* 17 C.F.R. Part 30.