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

CFTC letter No. 06-18
August 24, 2006
No-Action
Office of General Counsel

Jorge Alegria Formoso
Chief Executive Officer
Mercado Mexicano de Derivados, S.A. de C.V.
Paseo de la Reforma 255
Cuauhtémoc 06500
México, D.F.

Re: Mercado Mexicano de Derivados, S.A. de C.V.'s Request for No-Action Relief in Connection with the Offer and Sale in the United States of its Futures Contract Based On the Mexican Stock Exchange's Price and Quotation Index

Dear Mr. Formoso:

This letter is in response to letters, attachments, facsimiles and electronic mail dated from September 12, 2005 to August 2, 2006, requesting on behalf of Mercado Mexicano de Derivados, S.A. de C.V. ("MexDer") 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 ("US") of MexDer's futures contract based on the Mexican Stock Exchange's Price and Quotation Index ("IPC" or "Index").

We understand the facts to be as follows. MexDer is a futures and options exchange located in Mexico that is duly incorporated and authorized by the Mexican financial authorities to act as a derivatives exchange.[1] The financial authorities in Mexico include the Secretaria de Hacienda y Crédito Público, the Banco de México, and the Comisión Nacional Bancaria y de Valores ("CNBV"). Market surveillance in the securities and derivatives markets in Mexico is conducted by the CNBV, which is authorized under Mexican law to execute agreements with national and international bodies performing similar surveillance activities and provide them with assistance when required.[2]

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[1] *See* letter from Jorge Alegria Formoso, Chief Executive Officer, MexDer, to Patrick J. McCarty, General Counsel, CFTC, dated September 12, 2005.

[2] *See* electronic mail from Rafael Garcia Job, Sudirector Jurídico, MexDer, to Julian E. Hammar, Counsel, CFTC, dated February 3, 2006.

The IPC is a broad-based, market-capitalization-weighted composite security index of highly capitalized and actively traded stocks currently listed on the Bolsa Mexicana de Valores, S.A. ("Mexican Stock Exchange" or "BMV"). BMV generally selects for inclusion in the IPC stocks from its marketability index that were among the 35 most liquid during each of the previous six months prior to its annual review of the IPC's composition.[3] Based on data supplied by MexDer, the total market capitalization of the IPC was approximately US$ 155.6 billion as of August 30, 2005.[4] Also as of that date, the largest single security by weight represented 16.97%, and the five most heavily-weighted securities represented 55.48%, of the IPC.[5] The securities comprising the lowest 25% of the Index had a six-month aggregate dollar value of average daily trading volume in excess of US$ 30 million: approximately US$ 65.4 million for the 6-month period ending August 2005.[6] The Index is calculated in real time and is disseminated by electronic means through major data vendors, including Bloomberg and Reuters.[7]

MexDer's IPC futures contract provides for cash settlement. Prices are quoted in Index points with each Index point equal to 10 Mexican pesos per contract. The minimum price movement is one Index point. MexDer lists for trading the four nearest months of the March quarterly cycle (March, June, September and December). The last trading day of the contract is the third Friday of the contract month (or, if such day is not a business day, the business day immediately preceding such Friday). Cash settlement occurs on the first business day following the last trading day of the contract. The final cash settlement price for the contract is the closing level of the IPC on the last trading day.[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 US of

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[3] *See* letter from Mr. Formoso to Mr. McCarty, dated September 12, 2005, at Exhibit (E)(iii). If there are not 35 stocks meeting this criterion, the BMV selects stocks based on the capitalization and the frequency of inclusion in the marketability index. *Id.*

[4] *Id.* at Exhibit E(ii).

[5] *Id.* at Exhibits E(ii) and F.

[6] *Id.* at Exhibits E(v) and F.

[7] *Id.* at Exhibit E(i).

[8] *Id.* at Exhibits A-1 and E(iv).

[9] 7 U.S.C. § 1 *et seq.*

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

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 remains exclusive with regard to futures contracts on a group or index of securities that are 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 US, 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]

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

[12] 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).

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

[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

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 US 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.[17]

Accordingly, this Office has examined the IPC and MexDer'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 IPC, and MexDer's futures contract based thereon, conform to these requirements.[18]

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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).

[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, the Commission staff has concluded that the IPC 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. In addition, the IPC Index is excluded from the definition of a narrow-based security index pursuant to Section 1a(25)(B)(ii) of the CEA. In this regard, the Commission approved the Chicago Mercantile Exchange's futures contract based on the IPC on May 22, 1996, prior to the enactment of the CFMA. *See* letter from Jean A. Webb, Secretary, CFTC, to Norman E. Mains, Senior Vice President, Chief Economist & Director of Research, Chicago Mercantile Exchange, dated May 22, 1996.

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 securities underlying the IPC are listed and traded on BMV. Under Mexican law, only the Secretaria de Hacienda y Crédito Público, the Banco de México, and the CNBV are authorized to carry out market surveillance activities on the BMV, with CNBV having the primary responsibility for conducting such surveillance.[19] Thus MexDer does not have access to information regarding the securities underlying the IPC.

However, the CNBV has access to market surveillance information, including customer identification information with regard to securities transactions conducted on BMV and futures transactions conducted on MexDer.[20] Mexican Law authorizes the CNBV to share such information with foreign authorities pursuant to an exchange of information agreement.[21] Both the CNBV and the CFTC are signatories to the IOSCO Multilateral Memorandum of Understanding Concerning Consultation and Cooperation and the Exchange of Information ("IOSCO MOU").[22] The CNBV has represented that it is willing and able to share information, including the identity of the ultimate customer to a transaction, with the CFTC pursuant to the terms of the IOSCO MOU, with regard to the IPC Index futures contract traded on MexDer and the securities underlying the IPC Index.[23] Thus, the CNBV should have access to information necessary to detect and deter manipulation, and may share such information with the CFTC.[24] In the event that CNBV is unable to obtain access to adequate surveillance data in this regard, or is

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[19] *See* letter from Mr. Formoso to Mr. McCarty, dated September 12, 2005, at Exhibit C.

[20] *See* letter from Jorje Alegria Formoso, Chief Executive Officer, MexDer, to Patrick J. McCarty, General Counsel, CFTC, dated February 10, 2006, at 1-3.

[21] *Id.* at 4.

[22] 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.

[23] *See* letter from Miguel Angel Garza, Vice President (Supervision of Financial Institutions and International Affairs), CNBV, to Nanette R. Everson, General Counsel, CFTC, dated August 2, 2006.

[24] MexDer represents that there are no restrictions in Mexican law (e.g. blocking statutes) that would impact the CFTC's ability to obtain information from CNBV, other than a requirement that an exchange of information agreement must be previously executed with CNBV before CNBV may share information with a foreign authority. MexDer has represented that the IOSCO MOU satisfies this provision of Mexican law.

unable to share such data with the CFTC, this Office reserves the right to reconsider the position we have taken herein.[25]

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 MexDer's futures contract based on the IPC is offered or sold in the US. 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 MexDer with all regulatory requirements imposed by the CNBV, and the applicable laws and regulations of Mexico. 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 US of MexDer's futures contract on the IPC 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 US.[26]

Sincerely,

Nanette R. Everson
General Counsel

[25] The CNBV and the CFTC are also signatories to a Memorandum of Understanding on Consultation, Technical Assistance, and Mutual Assistance for the Exchange of Information, dated May 11, 1995. MexDer is a signatory to the International Information Sharing Memorandum of Understanding and Agreement signed on March 15, 1996, at Boca Raton, Florida.

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