Financial Services and Products ADVISORY

June 10, 2010

CFTC Issues Advisory Clarifying the Extent to which U.S. Investors May Trade in Foreign Security Futures Products

On June 8, 2010, the Commodity Futures Trading Commission's (CFTC) Division of Clearing and Intermediary Oversight (DCIO) issued an advisory (the "CFTC Advisory" or "Advisory") clarifying the extent to which certain sophisticated customers located in the United States may trade in foreign security futures products (FSFPs).[1] An FSFP is a security future listed for trading on a non-U.S. exchange. The CFTC issued the Advisory to address questions raised by market participants following the U.S. Securities and Exchange Commission's (SEC) publication of an order (the "SEC Order") on June 30, 2009, granting an exemption permitting certain sophisticated customers to trade FSFPs.[2]

Background

The Commodity Futures Modernization Act of 2000 (CFMA) granted the CFTC and the SEC joint jurisdiction over single stock futures and narrow-based stock indices (referred to as "Security Futures"). The CFMA defines security future products as "securities" under the Securities Exchange Act of 1934 (the "Exchange Act") and as "contracts for sale for future delivery" under the Commodity Exchange Act (CEA), subjecting Security Futures to the jurisdiction of both agencies. Broad-based security index futures and options on such futures, however, remain under the sole jurisdiction of the CFTC.

The CFMA also granted the CFTC and the SEC the authority to jointly issue rulemakings to permit the offer and sale of FSFPs to U.S. investors as "necessary and appropriate to permit the offer and sale of security futures product traded on or subject to the rules of a foreign board of trade."[3] The CFMA amended Section 2(a)(1)(F)(ii) of the CEA to permit eligible contract participants (ECPs)[4] to trade FSFPs "to the same extent"

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1 *See* CFTC Division of Clearing and Intermediary Oversight Advisory, "Division of Clearing and Intermediary Oversight Advisory Concerning the Offer and Sale of Foreign Security Futures Products to Customers Located in the United States," issued June 8, 2010, *available at* http://www.cftc.gov/ucm/groups/public/@internationalaffairs/documents/file/fsfpadvisory.pdf.

2 *See* 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, dated June 30, 2009, *available at* http://sec.gov/rules/exorders/2009/34-60194.pdf.

3 *See* Commodity Exchange Act, 7 U.S.C. 2 §2(a)(1)(E).

4 As defined under Section 1a(12) of the CEA, a U.S. person is considered an ECP if they (1) act for their own account and are a financial institution; (2) are a state regulated insurance company; (3) are a federally-regulated investment company; (4) are a commodity pool whose total assets exceed $5 million; or (5) are a business organization whose total assets exceed $10 million.

they are permitted to trade foreign securities.[5] Section 6(h)(1) of the Exchange Act, however, requires security future products to be listed for trading on national exchanges or a national securities association. As a result, U.S. investors generally are prohibited from entering into transactions for the purchase or sale of FSFPs on foreign exchanges.

Who May Trade FSFPs?

The recent SEC Order, however, provides an exemption from that prohibition and permits certain sophisticated customers, primarily qualified institutional buyers (QIBs) as defined in Rule 144A, to trade certain FSFPs. The SEC Order permits the following FSFPs to be traded by QIBs: (1) a security future on a single security, the underlying security of which must be issued by a foreign private issuer and has its primary trading market outside the United States, or a debt security issued or guaranteed by a foreign government that is eligible for registration with the SEC, and (2) a narrow-based security index, comprised of at least 90 percent securities issued by foreign private issuers where the primary trading market of each underlying security is outside the United States, or debt securities issued or guaranteed by foreign government and eligible for registration with the SEC.

With respect to market intermediaries, the SEC Order permits registered broker-dealers and unregistered foreign brokers[6] to offer and sell FSFPs to U.S. investors.

CFTC Clarification

In light of the SEC Order, the CFTC Advisory clarifies that the provisions of the CEA applicable to the offer and sale of FSFPs to eligible U.S. investors who are ECPs remain unchanged. Presently, any intermediary that wants to trade Security Futures must register with either the SEC or the CFTC and file a notice registration with the other agency. Thus, QIBs trading in reliance upon the exemption provided for in the SEC Order and pursuant to Commission Regulation 30.4(a) may use as an intermediary:

- a registered FCM who is a notice registered broker-dealer;
- a registered broker-dealer who is a notice registered FCM; or
- a foreign broker exempt from FCM registration pursuant to Commission Regulation 30.10, subject to the provisions of the SEC Order that are applicable to foreign brokers.

How Does the CFTC Advisory Impact Trading of FSFPs?

The CFTC Advisory highlights the issue and clarifies that although the CEA may permit ECPs to trade FSFPs on the same basis as any other foreign security, the provisions of the Exchange Act do not. Accordingly, in accessing foreign markets to trade FSFPs, U.S. traders must be mindful of the requirements under the Securities Act as well. In this regard, U.S. QIBs may trade FSFPs, but only through intermediaries as permitted in the SEC Order that also satisfy the CFTC registration requirements.

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5 CEA at §2(a)(1)(F)(ii).

6 Pursuant to the SEC Order, unregistered foreign brokers may serve as intermediaries pursuant to either the exemption set forth in Rule 15a-6 of the Exchange Act or the new conditional exemption set forth in the SEC Order that limits "the foreign broker's actions solely to inducing or attempting to induce the purchase and sale of any FSFP by a QIB, and routing the transaction through a registered broker or a notice-registered broker for execution." *See* CFTC Advisory at 4.

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