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## CFTC Issues Advisory Regarding Offer and Sale of Foreign Security Futures Products to U.S. Persons

The Commodity Futures Trading Commission's Division of Clearing and Intermediary Oversight (DCIO) has issued an Advisory regarding the offer and sale of foreign security futures products (FSFPs) to investors in the United States. In the Advisory, DCIO addresses the impact of a June 2009 Order issued by the Securities and Exchange Commission (SEC Order), which would permit the offer and sale of certain FSFPs to qualified U.S. investors. The DCIO Advisory reflects the CFTC staff's view that the SEC Order (described below) "does not modify the existing regulatory program" applicable to the offer and sale of FSFPs under the Commodity Exchange Act (CEA). However, the SEC Order significantly narrows the class of U.S. investors that otherwise would be permitted to trade FSFPs under the CEA.

FSFPs include futures on single stocks and narrow-based stock indices traded on exchanges or boards of trade outside the United States and are subject to the joint jurisdiction of the CFTC and the SEC. With respect to the CFTC's jurisdiction, Section 2(a)(1)(F)(ii) of the CEA provides that investors who qualify as "eligible contract participants" (ECPs) are permitted under the CEA to trade FSFPs on foreign exchanges to the same extent that such investors could trade the underlying stock(s). However, because Section 6(h)(1) of the Securities Exchange Act of 1934 (the 1934 Act) prohibits trading in security futures products that are not listed for trading on SEC-regulated national securities exchanges or national securities associations, U.S. investors generally have been precluded from trading FSFPs on foreign exchanges.

The SEC Order sets out an exemption from the 1934 Act listing requirement, permitting U.S. persons who qualify as "qualified institutional buyers" (QIBs)<sup>2</sup> as defined in Rule 144A under the Securities Act of 1933 (the 1933 Act) and certain qualified intermediaries on their behalf to trade specified FSFPs.<sup>3</sup> The following FSFPs are covered by the SEC Order: (i) single-stock futures on stocks of "foreign private issuers" (as defined under SEC

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<sup>1</sup> A category which generally includes very-high-net-worth individuals and certain regulated financial institutions and other investment vehicles (subject to asset-based requirements of generally between \$5 million and \$10 million).

<sup>2</sup> Subject to certain exceptions, QIB status generally requires that the investor be an institution and own or invest on a discretionary basis at least \$100 million in securities of unaffiliated issuers.

<sup>3</sup> The SEC Order also clarifies that U.S. securities laws do not affect the ability of non-"U.S. Persons" to trade in FSFPs and adopts the definition of "U.S. Person" used in Regulation S under the 1933 Act in determining the application of the rule.

regulations) having a primary trading market outside of the United States;<sup>4</sup> (ii) futures on narrow-based indices, at least 90% of the component stocks of which are stocks of “foreign private issuers” having a primary trading market outside of the United States; and (iii) certain FSFPs on foreign government debt and related indices. The SEC Order limits the exemption to transactions in FSFPs that are (x) effected on, or subject to the rules of, an exchange or contract market that is not required to register with the SEC under the 1934 Act, and (y) cleared and settled outside of the United States.

The SEC Order also sets out a new conditional exemption from broker-dealer registration for foreign brokers and dealers in connection with their efforts to induce the purchase of FSFPs by qualifying QIBs.<sup>5</sup> In its Advisory, DCIO notes that transactions in FSFPs may be intermediated by registered futures commission merchants (FCMs) that are notice-registered with the SEC as broker-dealers, registered broker-dealers that are notice registered with the CFTC as FCMs, and foreign brokers that are exempt from registration as FCMs pursuant to CFTC Rule 30.10, subject, however, to the applicable requirements of the SEC Order. Because the SEC Order does not authorize QIBs to effect trades in FSFPs other than through a registered broker-dealer (or notice-registered broker-dealer), a foreign firm that is exempt from registration as an FCM under CFTC Rule 30.10 likely would not be permitted to carry accounts of U.S. customers trading FSFPs.

The SEC Order emphasizes that all other provisions of the securities acts continue to apply to FSFPs, including the registration requirements of the 1933 Act and the requirements of Section 5 of the 1934 Act (regarding exchange registrations). Accordingly, offers and sales of FSFPs to U.S. persons must be effected in accordance with existing exemptions from these registration requirements (for example, pursuant to a private placement under Section 4(2) of the 1934 Act). The SEC has not provided specific guidance regarding the circumstances under which a foreign exchange or clearinghouse would satisfy these exemptions with respect to the offer and sale of listed FSFPs (for example, whether a disclosure regime similar to that which currently applies to foreign-listed equity options, pursuant to a series of no-action letters granted to various foreign exchanges,<sup>6</sup> must be implemented). In light of the unique characteristics of FSFPs—which are continuously issued by the relevant clearing organization or clearinghouse—the circumstances under which the offer and sale of FSFPs to U.S. investors would qualify for these exemptions remain unclear.

The SEC Order may not “modify the existing regulatory program” of the CFTC directly. Nonetheless, since market participants must comply with both CFTC and SEC requirements regarding FSFPs, the heightened investor qualification and other requirements established by the SEC Order indirectly, and substantially, limit the class of U.S. market participants that may trade these products.

The DCIO Advisory is available at: <http://www.cftc.gov/ucm/groups/public/@internationalaffairs/documents/ssproject/fsfpadvisory.pdf>.

The SEC Order is available at: <http://sec.gov/rules/exorders/2009/34-60194.pdf>.

<sup>4</sup> The SEC Order provides that a security’s primary trading market will be deemed to be outside the United States if at least 55% of the worldwide trading volume in such security took place in, on or through the facilities of markets located in no more than two foreign jurisdictions during the issuer’s most recently completed fiscal year.

<sup>5</sup> The SEC also affirmed that foreign brokers and dealers may rely on the existing exemptions from broker-dealer registration set out under Exchange Act Rule 15a-6, subject to the requirements of such Rule.

<sup>6</sup> See, e.g., ASX Limited, SEC No-Action Letter (August 13, 2007), available at <http://www.sec.gov/divisions/marketreg/mr-noaction/asxo81307.pdf>.

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