

Foreign Market Access

*CFTC Regulation of Foreign Boards of Trade and
US Participation on Foreign Boards of Trade*

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Overview

- Background:
 - Historic CFTC Approach To Foreign Market Access.
 - Approach Following the Dodd-Frank Act.
- Process of Registering a Foreign Board of Trade.
- Doing Business on a Foreign Board of Trade.
- Status of Non-US SEFs.
- Current Developments.

Background to the Current Framework

- Late 90's - Early 2000's.
 - CFTC enters information-sharing / cooperation agreements with foreign regulators as technology enables global trading.
 - 1996: Deutsche Terminbourse No-Action Letter.
- Access Permitted Through No-Action Letter Process.
 - Terminals placed without contract market designation under Section 5 of the Commodity Exchange Act.
 - Permit trading by FBOT Members, FCMs trading proprietary accounts, FCMs placing orders for customers, CPOs/CTAs (with exempt equivalents) trading pools / discretionary accounts.
 - Standards: substantial equivalence with CFTC oversight of designated contract markets.
 - Factors considered include:
 - Regulatory regime and enforcement.
 - Nature of the products to be offered.
 - Order execution functions.
 - Clearance and settlement.
 - Information sharing.
 - Systems integrity, security and architecture.

Evolving Products and Standards: 2006 - 2010

- 2006-2008: ICE Futures Europe proposal to trade contracts linked to NYMEX contract prices. Over time, conditions are established for linked contracts:
 - Large trader reporting.
 - Publication of daily trading information.
 - Position limits / accountability levels.
 - Trade execution data.
 - Audit trail data.
 - Access to rules and disciplinary data.
 - Linked cease-trading procedures.

CEA Section 4(b) / Dodd Frank Act Section 738

- 2010: Dodd-Frank Act authorizes CFTC regulations for FBOT registration.
- Draws from CFTC No-Action Letter precedent.
 - *Direct Access*: explicit grant of authority by FBOT to an identified member or other participant located in the US to enter trades directly into its trade matching system.
 - CFTC to consider whether the FBOT is subject to comparable, comprehensive supervision and regulation in its home country. Any prior findings to be included.
 - Special conditions for linked contracts:
 - Public daily trading information comparable to that published by the CFTC-registered entity;
 - Position limits (hedge exemptions permitted) comparable to those at US-registered entity.
 - Authority to require traders to limit / reduce positions to prevent or reduce price manipulation, excess speculation, price distortion, and disruption of delivery or cash settlement process.
 - Information to CFTC regarding large trader positions comparable to that collected by the CFTC for the referenced contracts.
 - Information to CFTC as necessary to publish reports on aggregate trader positions comparable to those for the referenced contract.
 - Prompt notice to CFTC of changes in reporting, position limits, other developments.

FBOT Registration Process

- CFTC Rules Part 48 (17 CFR 48).
 - Replaces former No-Action Letter process.
 - Requesting confidentiality.
 - CFTC on-site visits.
- Form FBOT with supporting documentation. Significant materials include:
 - Terms and conditions of contracts to be traded.
 - Linked contracts.
 - Clearing requirement.
 - Membership standards, including financial resources.
 - Description of execution system, systems architecture (including description of trade matching algorithm).
 - Description and documentation as to home country regulation.
 - FBOT rules, surveillance and enforcement information.
 - Information sharing arrangements.

Clearing Organization

- Supplement S-1 with supporting documentation. Significant materials include:
 - Membership standards, including financial resource requirements.
 - Manner in which the clearing organization evaluates financial resources of members or other participants.
 - Description of clearing and settlement systems, including interface with the trading system.
 - Certification and description re: clearing organization's observation of Recommendations for Central Counterparties (RCCPs).
 - Home country regulations; clearing organization rules, compliance structure and enforcement information.
 - Information sharing arrangements.

The CFTC's Standards

- Access Eligibility:
 - Identified members or other participants entering orders for their own accounts.
 - FCMs submitting orders on behalf of customers.
 - Registered CPOs / CTAs (or exempt counterparts) that submit orders on behalf of pools / discretionary accounts, provided that a registered FCM (or a firm exempt from FCM registration) acts as a clearing firm and guarantees trades.
- Principles-based review: staff seeks to determine if the local authorities support and enforce regulatory objectives in the oversight of the FBOT and the clearing organization that are substantially equivalent to those of the CFTC.
- Seven broad areas of assessment:
 - FBOT and Clearing Organization Membership Standards.
 - The Automated Trading System.
 - Terms and Conditions of Contracts Available for Trading.
 - Settlement and Clearing.
 - Regulatory Regime Governing the FBOT and Clearing Organization.
 - FBOT and Clearing Organization Rules and Enforcement.
 - Information Sharing among the CFTC, the FBOT and Local Regulator.

Membership

- **FBOT and Clearing Organization Membership Standards.**
 - Members and other participants of the FBOT and clearing organization are fit and proper and meet appropriate financial and professional standards.
 - FBOT and clearing organization have and enforce provisions to minimize and resolve conflicts of interest.
 - FBOT and clearing organization have and enforce rules prohibiting disclosure of material non-public information by members of boards and significant committees.

Trading System Standards

■ **The Automated Trading System.**

- Compliance with IOSCO Principles for the Oversight of Screen-Based Trading Systems for Derivative Products.
- Trade matching algorithm matches trades fairly and timely.
- Audit trail captures all relevant data, including changes to orders; audit trail data is securely maintained and available for an adequate time period.
- Adequate and appropriate trade data is made available to users and the public.
- The trading system has demonstrated reliability.
- Access to the trading system is secure and protected.
- Adequate provisions for emergency operations and disaster recovery.
- Trading data is backed up to prevent loss of data.
- Contracts limited to those identified in application or added later via Rule 48.10.

Contracts, Settlement and Clearing

■ **Terms and Conditions of Contracts.**

- Futures, options or swaps that would be eligible for trading on a designated contract market.
- Must be cleared.
- Not readily susceptible to manipulation.
- Foreign futures and options on non-narrow-based security indexes must have been certified by CFTC.
- Linked contracts (or those with any other relationship with a contract listed for trading on a registered entity) must be specifically identified.
 - Subject to Section 4(b) standards plus enhanced reporting, access to T+1 trade data, and reporting as to regulatory actions.

■ **Settlement and Clearing.**

- The clearing organization is registered with the CFTC as a DCO, or observes the Recommendations for Central Counterparties / Principles for Financial Market Infrastructures.
- The clearing organization is in good regulatory standing in its home jurisdiction.



Rules, Regulations and Enforcement

- **Home Country Regulatory Regime.**

- Comprehensive supervision and regulation comparable to CFTC standards.
- Ongoing supervision and oversight of market integrity, customer protection, clearing, settlement and enforcement of the rules of the FBOT and the clearing organization.
- Regulatory authorities authorized to share information directly with CFTC and to intervene in the market.

- **FBOT and Clearing Organization Rules and Rule Enforcement.**

- Ability to detect, investigate, and sanction violations.
- Disciplinary procedures for suspected violations, adequate sanctions for violations, protection for charged parties.
- Ability to obtain information and cooperation from members and other participants for investigations and enforcement.
- Sufficient compliance staff and resources to fulfill regulatory responsibilities (delegation and/or outsourcing permitted).
- Rules re: access and connection to the trading system.
- Audit trail captures/retains order and trade data to allow detection of abuses and to reconstruct all transactions within a reasonable time.
- Enforces rules prohibiting fraud and abusive trading practices (e.g., wash sales, trading ahead).
- Able to detect and deter, enforces rules against manipulation, price distortion and other disruptions.
- Rules and procedures to ensure competitive, open and efficient markets and executions.

Information Sharing

■ Information Sharing.

- *Local regulators* have signed IOSCO Multilateral Memorandum of Understanding, or otherwise satisfactory information sharing arrangements are in place.
- *Local regulators* have signed the Declaration on Cooperation and Supervision of International Futures Exchanges and Clearing Organizations or otherwise commit, in writing, to share information contemplated by the International Information Sharing Memorandum of Understanding and Agreement with the CFTC.
- *FBOT* has executed the International Information Sharing Memorandum of Understanding and Agreement.
- *FBOT and clearing organization* agree to provide directly to the CFTC, upon request, information necessary to evaluate continued eligibility and appropriateness of the registration, to audit for and enforce compliance with requirements of the registration, and to permit the CFTC to carry out its mission.

International Standards and Agreements

- IOSCO Principles for the Oversight of Screen-Based Trading Systems for Derivative Products.
 - Principles-based framework for trading systems emphasizing regulatory cooperation, information sharing, system security, market fairness and transparency.
- Recommendations for Central Counterparties / Principles for Financial Market Infrastructures.
 - Joint Report by Committee on Payment and Settlement Systems and IOSCO Technical Committee with recommendations addressing cover major types of risk faced by CCPs.
 - The *Principles* (2012) updates and replaces RCCP (2004).
- IOSCO Multilateral Memorandum of Understanding.
 - Broad agreement for prompt sharing of information in law enforcement investigations.
- Declaration on Cooperation and Supervision of International Futures Exchanges and Clearing Organizations / International Information Sharing Memorandum of Understanding and Agreement.

United States Customers

- CFTC Rules Part 30: to ensure that foreign products offered or sold in the U.S. are subject to safeguards comparable to domestic transactions.
 - Products: futures and options traded on FBOTs are “foreign futures and options.”
 - Customers: A person located *in* the United States who trades foreign futures and options is a “foreign futures or options customer.”
- US or Non-US Persons Acting as Intermediaries:
 - Rule 30.4: requires registration in appropriate capacity (FCM, IB, CPO, CTA) or exemption from registration under Rules 30.5 or 30.10.
 - Exception: Trades executed on an FBOT and carried at a designated contract market pursuant to agreements allowing cross-market liquidation and execution.
- Specific disclosures required.
- Anti-fraud provisions (Rule 30.9) apply regardless of exemptions.

Registration Matters

- Rule 30.5: Persons not located in the United States, other than FCMs, may apply for exemption from registration.
 - IBs, CPOs, CTAs.
 - 7-R filing with National Futures Association.
 - Written agency agreement for service of process.
 - CFTC access to records.
 - Use of a registered FCM or a Rule 30.10 exempt foreign broker.
- FCMs: Registration generally required.
 - Exception: Foreign futures and options brokers (i) accepting orders from and carrying a US FCM's foreign futures and options customer omnibus account; (ii) accepting orders from and carrying a US FCM's proprietary account, and/or (iii) accepting orders from and carrying a US affiliate account proprietary to the foreign broker.
- Rule 30.10:
 - Petitions for exemptions, including relief from registration.
 - Standards for non-US persons with banking branches or divisions in the United States.

Foreign Futures or Options Secured Amount

- Rule 30.7: requires FCMs to “maintain in a separate account or accounts money, securities and property in an amount at least sufficient to cover or satisfy all of its current obligations to foreign futures or foreign options customers denominated as the *foreign futures or foreign options secured amount*.”
 - *Foreign futures or foreign options secured amount*: Money, securities and property received by FCM (i) to margin, guarantee, or secure foreign futures contracts and all money accruing to such 30.7 customers as a result; (ii) in connection with foreign options transactions representing premiums payable or premiums received, or to guarantee or secure performance on such transactions; and (iii) money accruing to 30.7 customers as the result of trading in foreign futures contracts or foreign options.
 - Specified account name / permitted location of 30.7 customer funds.
 - Required written acknowledgments from depositories.
 - Commingling issues.
 - Limitations on use of 30.7 funds.

Status of Non-US SEFs

- November 2013: Staff guidance indicating strong SEF registration preference.
- CFTC Staff No-Action Letters 14-46 (April 9, 2014); 15-29 (May 15, 2015).
 - Conditional relief from registration with CFTC as a swap execution facility (SEF). Related relief for participants transacting on such markets, such as from trade execution and certain trade reporting requirements.
 - For requesting non-US multilateral trading facilities (MTFs) overseen by EU and Australian regulators. Conditions relating to order books, execution methods, straight-through processing, block sizes, swap data reporting and regulatory oversight.
 - Limited use: Yieldbroker PTY Limited (Sept. 14, 2016) (Australian licensed swap-trading platform).
- Continuing effective fragmentation of markets.
- Outlook of new leadership.

Questions



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