



## U.S. COMMODITY FUTURES TRADING COMMISSION

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Division of Clearing and  
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### **DIVISION OF CLEARING AND INTERMEDIARY OVERSIGHT ADVISORY CONCERNING THE OFFER AND SALE OF FOREIGN SECURITY FUTURES PRODUCTS TO CUSTOMERS LOCATED IN THE UNITED STATES**

Summary: This Advisory clarifies the extent to which certain sophisticated customers located in the U.S. may transact in foreign security futures products (“FSFPs”).

#### **I. Introduction**

The Commodity Futures Modernization Act of 2000 (“CFMA”)<sup>1</sup> eliminated a longstanding prohibition against the trading of security futures products by U.S. investors. A security future generally is defined as a contract of sale for future delivery of a single security or of a narrow-based security index. An FSFP therefore is a security future listed for trading on an exchange located outside the U.S. Prior to the passage of the CFMA, U.S. investors could only trade foreign securities pursuant to provisions set forth in the federal securities laws, and broad-based security-index futures contracts pursuant to no-action relief issued by the Commission staff. The CFMA provided for access by U.S. persons to foreign security futures products, which are defined as both a “contract of sale for future delivery” subject to the jurisdiction of the Commission and a “security” subject to the jurisdiction of the Securities and Exchange Commission (“SEC”).

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<sup>1</sup> Appendix E of Pub. L. No. 106-554, 114 Stat. 2763 (2000).

As set forth in Section 2(a)(1)(E) of the Commodity Exchange Act (“CEA”), the Commission and the SEC were directed by Congress to jointly issue such rules, regulations or orders as are appropriate and necessary to permit the offer and sale of FSFPs to U.S. investors. Section 2(a)(1)(F)(ii) of the CEA further states that, notwithstanding the limitation in subparagraph (E), eligible contract participants (“ECPs”) would be permitted to trade FSFPs to the same extent that they were permitted to trade foreign securities. For example, SEC Rule 15a-6 under the Securities Exchange Act of 1934 (“Exchange Act”) generally permits certain sophisticated U.S. investors to trade foreign securities on an unsolicited basis. However, the CFMA did not add to the Exchange Act a parallel provision to CEA Section 2(a)(1)(F)(ii). Moreover, the CFMA also added Section 6(h)(1) to the Exchange Act, which requires security futures products to be listed for trading on national securities exchanges or national securities associations. Because of this requirement, U.S. investors have been precluded from entering into transactions for the purchase or sale of FSFPs on foreign exchanges.

## **II. The SEC’s June 30, 2009 Order<sup>2</sup>**

On June 30, 2009, the SEC issued an Order (“SEC Order” or “Order”) granting, among other things, an exemption from Exchange Act Section 6(h)(1) to permit certain sophisticated customers to effect transactions in certain FSFPs.<sup>3</sup> In issuing the Order, the SEC noted that U.S. investors have expressed strong views since 2001 that U.S. institutional investors need to be able to trade in FSFPs for risk management, asset allocation and other purposes, and suffer substantial

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<sup>2</sup> The following is only a summary of the SEC Order; for the full Order, please refer to the following webpage: <http://sec.gov/rules/exorders/2009/34-60194.pdf>.

<sup>3</sup> 74 Fed. Reg. 32200.

adverse impact and competitive disadvantage with respect to non-U.S. investors by not being permitted to trade FSFPs.

The SEC Order limits the relief to only certain FSFPs and transactions undertaken by certain sophisticated U.S. investors. Specifically, the Order specifies that only the following FSFPs are covered by the relief: (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 U.S.,<sup>4</sup> 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 U.S., or debt securities issued or guaranteed by a foreign government and eligible for registration with the SEC. The FSFP transaction must be effected on a foreign exchange along with the clearance and settlement. For more precise details regarding the class of products covered under these provisions, please refer to the Order.

The SEC Order further states that only specific sophisticated U.S. investors may transact in FSFPs, primarily qualified institutional buyers (“QIBs”) as defined in Rule 144A issued pursuant to the Securities Act of 1933 (“Securities Act”). Under Rule 144A, QIBs are persons who “in the aggregate own and invest on a discretionary basis at least \$100 million in securities of issuers.” In comparison, a U.S. investor is considered to be an ECP under Section 1a(12) of the CEA if they act for their own account and are a financial institution, a state-regulated insurance

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<sup>4</sup> The SEC Order defines a security’s primary trading market outside the U.S.,

if at least 55 percent of the worldwide trading volume in the security took place in, on, or through the facilities of a securities market or markets located either (i) in a single foreign jurisdiction, or (ii) in no more than two foreign jurisdictions during the issuer’s most recently completed fiscal year. If the trading in the foreign private issuer’s security is in two foreign jurisdictions, the trading for the issuer’s security in at least one of the two foreign jurisdictions must be greater than the trading in the U.S. for the same class of the issuer’s securities in order for such security’s primary trading market to be considered outside the U.S. 74 Fed. Reg. 32203-4. For additional information on the definition of a security’s primary trading market, please see the SEC Order.

company, a federally-regulated investment company, a commodity pool whose total assets exceed \$5 million, or a business organization whose total assets exceed \$10 million.

With respect to intermediaries, the SEC Order provides that registered broker-dealers would be permitted to offer and sell these products to qualifying U.S. investors. Due to the shared jurisdiction over security futures products, any intermediary is required to register with either the SEC or the Commission and may be notice-registered with the other agency. The Order provided further that unregistered foreign brokers may intermediate qualifying FSFP transactions pursuant to two registration exemption alternatives: (1) the exemptions provided in Rule 15a-6 issued pursuant to the provisions of the Exchange Act; or (2) the new conditional exemption specified in the SEC Order limiting the foreign broker's actions solely to inducing or attempting to induce the purchase or sale of any FSFP by a QIB, and routing the transaction through a registered broker or a notice-registered broker for execution.

### **III. The Offer and Sale of FSFPs under the CEA**

In consideration of the foregoing information, the Division of Clearing and Intermediary Oversight ("DCIO") is clarifying that the provisions of the CEA applicable to the offer and sale of FSFPs to eligible U.S. investors remain unchanged since the enactment of the CFMA and the issuance of the SEC Order. Accordingly, for QIBs trading pursuant to the exemption specified in the SEC Order, pursuant to Commission Regulation 30.4(a)<sup>5</sup> governing the offer and sale of foreign futures and options to U.S. investors, these transactions may be intermediated by any registered FCM who is also a notice-registered broker-dealer or conversely by any registered broker-dealer who is also a notice-registered FCM. Additionally, any foreign broker exempt

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<sup>5</sup> Commission Regulation 30.4(a) requires foreign futures brokers who seek to engage in the business of transacting in foreign futures and options with customers located in the U.S. to register with the Commission. Alternatively, under Commission Regulation 30.10, foreign futures brokers may petition for an exemption from registration if they prove to the satisfaction of the Commission that their home regulatory structure is comparable to that of the U.S.' 17 C.F.R. §§ 30.4(a), 30.10 (2009).

from FCM registration pursuant to Commission Regulation 30.10 also may intermediate FSFP transactions on behalf of QIBs subject to provisions of the SEC Order that are applicable to foreign brokers.

In summary, it is the position of DCIO that the SEC Order does not modify the existing regulatory program set forth in the CEA governing the offer and sale of FSFPs to U.S. investors who are ECPs. Any U.S. investor seeking to transact in FSFPs (and particularly ECPs that do not qualify as QIBs), and any firm seeking to intermediate such a transaction, should consult an attorney to determine whether such activities would be inconsistent with the federal securities laws. For any questions regarding the requirements set forth in the CEA or Commission regulations, please contact DCIO at [dcio@cftc.gov](mailto:dcio@cftc.gov).