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Division of Market Oversight

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Staff Advisory: Registration Framework for Foreign Boards of Trade Providing Direct Access to Members or Other Participants Located in the United States

The global derivatives markets continue to evolve due to innovation and technological advancement, leading to the development of new products, asset classes, and trading platforms both within the United States and in foreign jurisdictions. In order to promote regulatory clarity and access to markets, the Division of Market Oversight ("Division") of the Commodity Futures Trading Commission ("CFTC or Commission") issues this advisory to reaffirm the CFTC's longstanding foreign board of trade ("FBOT") registration framework for non-U.S. entities legally organized and operating outside the United States that seek to provide members or participants physically located in the United States with direct market access to their trading platforms.

A "foreign board of trade" is defined for this purpose as "any board of trade, exchange, or market located outside the United States, its territories or possessions . . . ."[1] A board of trade located inside the United States ("domestic board of trade") is subject to the designation framework for a designated contract market ("DCM") established under section 5 of the Commodity Exchange Act ("CEA").[2]

I. Background

Under CEA Section 4(a),[3] a futures contract may be traded lawfully in the United States only if, among other things, it is traded on or subject to the rules of a board of trade[4] that is a DCM.[5] Historically, futures trading from within the United States had to be on a DCM.

However, CEA section 4(a) also provides an exclusion from this requirement with respect to the trading of contracts that are "made on or subject to the rules of a board of trade, exchange, or market located outside the United States, its territories, or possessions."[6] The statutory text thus creates a territorial locus and distinction between two types of trading activity occurring in the United States: (1) trading of contracts listed on boards of trade that are located "in" the United

[1] 17 CFR § 48.2(a).
[2] 7 U.S.C. § 7.
[3] 7 U.S.C. § 6(a).
[4] The term "board of trade" is defined as any organized exchange or other trading facility. 7 U.S.C. § 1a(6).
[5] In order to obtain, and maintain, designation as a contract market, a board of trade must comply with statutory core principles for designated contract markets set forth in the CEA, as well as applicable CFTC rules and regulations. 7 U.S.C. § 7(d).
[6] *Id.*

States (domestic boards of trade); and (2) trading of contracts occurring in the United States listed on boards of trade that are located "outside" the United States (foreign boards of trade), based on the geographic location of the board of trade, exchange, or market.

In 1996, CFTC staff issued the first no-action letter to a board of trade located outside the United States, which was the beginning of the CFTC's regulatory approach to trading occurring in the United States of futures contracts listed on FBOTs. The no-action relief permitted an automated international futures and options exchange headquartered in Frankfurt, Germany, subject to certain terms and conditions, to place computer terminals in the U.S. offices of its members for principal trading without the German exchange having to become a DCM.[7] The German exchange's members could trade through the computer terminals ("electronic trading devices"), which provided access to the FBOT from a geographic location within the United States.

In 2000, following a series of "foreign trading system" no-action letters issued to FBOTs pursuant to a June 2, 1999 Commission order,[8] the Commission issued a Statement of Policy ("2000 Statement of Policy") in order to address the listing of new futures and options contracts by FBOTs that had received staff no-action relief to place electronic trading devices in the United States.[9] The 2000 Statement of Policy further developed the FBOT regulatory framework and demonstrated the CFTC's continuing view that access by U.S.-located persons to electronic trading of contracts on non-U.S. exchanges was permissible without becoming a DCM.

In 2006, the CFTC began public engagement to interpret the phrase "board of trade, exchange or market located outside the United States, its territories or possessions," as used in the exclusion under CEA section 4(a). The CFTC requested public comment on boards of trade located outside of the United States and the CEA requirement to become a DCM,[10] and on June 27, 2006, held a public hearing[11] where a number of panelists specifically supported the criterion of where the exchange was legally organized and where its head office was located as being the most important in determining where an exchange was "located".[12]

On November 2, 2006, after considering public comments, the Commission issued a policy statement ("2006 Statement")[13] interpreting the exclusion under CEA section 4(a) to apply with

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[7] CFTC Letter No. 96–28 (February 29, 1996). In June 1998, Deutsche Termibourse (DTB) changed its name to Eurex Deutscheland.

[8] *See* Access to Automated Boards of Trade, 64 FR 32829 (June 18, 1999).

[9] Notice of Statement of Commission Policy Regarding the Listing of New Futures and Options Contracts by Foreign Boards of Trade that Have Received Staff No-Action Relief to Place Electronic Trading Devices in the United States, 65 FR 41641 (July 6, 2000). Note that this 2000 Statement of Policy uses the terms "domestic board of trade" as well as "foreign board of trade."

[10] *See* Request for Comment, Boards of Trade Located Outside of the United States and the Requirement To Become a Designated Contract Market or Derivatives Transaction Execution Facility, 71 FR 34070 (June 13, 2006).

[11] *See* Sunshine Act Meeting Notice, 71 FR 30665 (May 30, 2006); corrected at 71 FR 32059 (June 2, 2006). The hearing was conducted on June 27, 2006.

[12] *See* Washington Watch, CFTC Holds Hearings on U.S. Access to Foreign Exchanges, July/August 2006, available at www.alston.com/-/media/files/insights/publications/2006/08/cftc-holds-hearings-on-us-access-to-foreign-exchan/files/washington-watch/fileattachment/washington-watch.pdf.

[13] Boards of Trade Located Outside of the United States and No-Action Relief from the Requirement to Become a Designated Contract Market or Derivatives Transaction Execution Facility, 71 FR 64443, 64446 (November 2, 2006).

respect to "bona fide" boards of trade — "boards of trade that, among other things, possess the attributes of established, organized exchanges, adhere to appropriate rules prohibiting abusive trading practices, have been authorized by a regulatory process that examines customer and market protections, and are subject to continued oversight by a regulator that has power to intervene in the market and share information with the Commission."

In that 2006 Statement, the Commission noted that commenters—including the Chicago Mercantile Exchange and the New York Board of Trade—emphasized that an exchange's management, ownership structure, or U.S.-based offices, marketing, or technology presence was insufficient to establish that it is "located in the United States."[14] The Commission also affirmed its support for staff's existing no-action process for FBOTs seeking to provide direct access to their trading systems from U.S.-located terminals.

The Dodd-Frank Act amended CEA section 4(b) in 2010 to authorize the CFTC to establish a registration framework for FBOTs offering direct access to members or other participants located in the United States.[15] On December 5, 2011, the Commission adopted final rules under this authority,[16] codified in Part 48 of the its regulations.[17] Part 48 prohibits an FBOT from providing such access unless it is registered with the CFTC.[18]

Part 48 sets forth application procedures and substantive requirements for FBOT registration with the CFTC. These requirements largely mirror the CFTC's prior no-action process, including conditions related to market oversight, transparency, and customer protection.[19]

II. Advisory

The Division is providing a reminder that a "foreign board of trade," as such term is defined in the Part 48 rules – namely, any board of trade, exchange or market located outside of the United States, its territories or possessions, whether incorporated or unincorporated[20] – must be registered with the CFTC in accordance with the procedures, requirements, and conditions set forth in the Part 48 rules, in order to provide members or other participants located in the United

[14] *Id*. at 64448.

[15] CEA section 4(b) provides that "direct access" refers to an explicit grant of authority by a foreign board of trade to an identified member or other participant located in the United States to enter trades directly into the trade matching system of the foreign board of trade.

[16] *See* Registration of Foreign Boards of Trade, 76 FR 80674 (Dec. 23, 2011) ("Part 48 adopting release").

[17] 17 CFR Part 48 ("Part 48 rules").

[18] 17 CFR § 48.3(a) ("Except as specified in this part, it shall be unlawful for a foreign board of trade to permit direct access to its electronic trading and order matching system unless and until the Commission has issued a valid and current Order of Registration to the foreign board of trade pursuant to the provisions of this part"). The rules define a "foreign board of trade" as any board of trade, exchange or market located outside of the United States, its territories or possessions, whether incorporated or unincorporated. 17 CFR § 48.2(a). *See also* 17 CFR § 48.2(c), defining "direct access" in a manner that tracks the statutory definition set forth in CEA section 4(b), as set forth in note 14, *supra.*

[19] *See, e.g.,* 76 FR 80675, describing the registration requirements set forth in CFTC Regulation 48.7 as being divided "into the same seven general categories evaluated during the course of a review of a request for FBOT no-action relief: membership criteria, trading system, contracts, settlement and clearing, regulatory authorities, rules and rule enforcement, and information sharing."

[20] 17 CFR § 48.2(a)

States with direct access to the electronic trading and order matching system of the FBOT. "Located" refers to geographic location.

For the avoidance of doubt, a FBOT that is registered with the CFTC in accordance with the Part 48 rules does not need to become a DCM in order to provide U.S.-located members or other participants with direct access[21] to the electronic trading and order matching system of the FBOT. Conversely, the Division is providing a reminder that a domestic board of trade that is located in the United States is subject to the DCM regulatory framework established under CEA section 5 and does not fall within the scope of the Part 48 rules.

Under CFTC regulation 48.4(b), an FBOT may permit U.S.-located members and other participants to access its electronic trading and order-matching system, provided they meet specific criteria. Access is limited to those who are: (1) entering orders for the member's or other participant's proprietary accounts; (2) registered with the CFTC as futures commission merchants ("FCMs") and are submitting customer orders to the trading system for execution; (3) subject to certain conditions, registered with the CFTC as a commodity pool operator ("CPO") or commodity trading advisor ("CTA"), or are exempt from such registration, and are submitting orders for execution on behalf of a U.S. pool that the member or other participant operates, or an account of a U.S. customer for which the member or other participant has discretionary authority, respectively; or (4) subject to certain conditions, registered with the CFTC as introducing brokers ("IB") and are submitting customer orders to the trading system for execution.[22]
To qualify for registration, an FBOT must also: (1) possess the attributes of an established, organized exchange; (2) adhere to appropriate rules prohibiting abusive trading practices; (3) enforce appropriate rules to maintain market and financial integrity; (4) have been authorized by a regulatory process that examines customer and market protections; and (5) be subject to continued oversight by a regulator that has power to intervene in the market and the authority to share information with the CFTC.[23]

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[21] As noted above, "direct access" refers to an explicit grant of authority by a foreign board of trade to an identified member or other participant located in the United States to enter trades directly into the trade matching system of the board of trade. Accordingly, for example, the act of providing "direct access" does not, of itself, involve "soliciting or accepting orders," or encompass other activity that may require a market participant located outside the United States to be registered with the CFTC as an FCM. 7 U.S.C. § 1a(28), in relevant part, defines a "futures commission merchant" as any individual, association, partnership, corporation or trust that (1) engages in soliciting or in accepting orders for, among other things, a futures contract, a security futures product, a swap, a commodity option, or any agreement, contract, or transaction described in CEA section (2)(c)(2)(D)(i), or acts as a counterparty in any agreement, contract, or transaction described in CEA section (2)(c)(2)(D)(i), and (2) in connection therewith, accepts any money, securities, or property (or extends credit in lieu thereof) to margin, guarantee, or security any trades or contracts that result or may result therefrom.

[22] 17 CFR § 48.4(b). Not all boards of trade located outside the United States qualify for registration under the Part 48 rules. In order to be eligible to be registered, a FBOT must satisfy the registration requirements set forth in CFTC regulation 48.7, which include a requirement for the FBOT to demonstrate that it is subject to "comprehensive supervision and regulation … that is comparable to the comprehensive supervision and regulation provided by the Commission to designated contract markets …" *See* § 48.4(a) and 7 U.S.C § 6(b)(1). *See also* 17 CFR § 48.7(e)(1) (the foreign board of trade's clearinghouse, and the contracts that the foreign board of trade will offer for direct access trading, also must be subject to comprehensive supervision that is comparable to that provided by the CFTC).

[23] 17 CFR § 48.2(b).

This advisory does not address all circumstances in which a contract must be transacted on a DCM.[24] The Division notes, for example, that pursuant to CEA section 2(e), retail market participants (market participants that are not "eligible contract participants"),[25] can only execute swap transactions on or subject to the rules of a DCM.[26] Retail trading of swaps cannot occur over-the-counter (i.e., off-exchange), or on or pursuant to the rules of a swap execution facility ("SEF"), a type of trading platform subject to a different regulatory framework under the Part 37 rules.[27]

III. Conclusion

By outlining the CFTC's registration framework for FBOTs, in contrast to the registration framework for DCMs, reiterating the longstanding interpretations of "domestic board of trade" and "foreign board of trade," and clearly identifying the key distinguishing factor as the geographic location of the board of trade, exchange, or market, this advisory is intended to promote regulatory clarity for non-U.S. entities legally organized and operating outside the United States that seek to provide U.S.-located members or participants with direct market access to their trading platforms.

This advisory is intended to reflect the views of the staff of the Division only and does not necessarily represent the views of the Commission.

Sincerely,

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[24] *See, e.g.,* 7 U.S.C. § 2(c)(2)(D).
[25] The term "eligible contract participant" is defined in 7 U.S.C. § 1a(18).
[26] 7 U.S.C. § 2(e).
[27] A "swap execution facility" is defined as a trading system or platform in which multiple participants have the ability to execute or trade swaps by accepting bids and offers made by multiple participants in the facility or system, through any means of interstate commerce, including any trading facility that – (A) facilitates the execution of swaps between persons, and (B) is not a designated contract market. 7 U.S.C. § 1a(50). No person may operate a facility for the trading or processing of swaps unless the facility is registered with the CFTC as a swap execution facility or as a designated contract market. 7 U.S.C. § 7b-3(a)(1). The CFTC may exempt, conditionally or unconditionally, a swap execution facility from registration if the CFTC finds that the facility is subject to comparable, comprehensive supervision and regulation on a consolidated basis by the appropriate governmental authorities in the home country of the facility. 7 U.S.C. § 7b-3(g).