
New US Registration Requirement for Foreign Boards of Trade

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I. Introduction

The Commodity Futures Trading Commission (CFTC) recently promulgated rules requiring the registration of foreign boards of trade (FBOTs) that provide United States members and participants with direct access to the FBOT's electronic trading and order matching systems.² The registration requirement replaces the current no-action process for permitting such direct market access. The new registration requirement will affect each FBOT that currently operates under no-action relief as well as all future applicants for registration. The new registration procedures apply a review standard highly similar to the existing no-action test, but require the submission to the CFTC of more information using a standardized format. In addition, under the new rules, FBOTs that list contracts which settle to the price of a contract traded on a US futures market will face additional reporting, information-sharing and other substantive requirements. The Commission explained that the new registration rules provide greater standardization of treatment and transparency than the former no-action process and thereby will provide greater legal certainty and promote fair and consistent treatment to all FBOT applicants. The rules become effective on February 21, 2012.

II. Statutory Origins

In a last-minute addition, the final version of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act)³ provided that the CFTC may adopt regulations requiring FBOTs that enable members located in the United States to directly access their electronic trading and order matching systems to register with the CFTC.⁴ The registration provision of the Dodd-Frank Act leaves the registration requirements to the discretion of the CFTC, requiring only that the Commission take into consideration:

1. whether any FBOT is "subject to comparable, comprehensive supervision and regulation by the appropriate governmental authorities" in its home country; and
2. whether there are any previous CFTC findings that the FBOT meets the standard that it is subject to such comparable and comprehensive regulation in its home country.⁵

III. Current No-Action Relief

Prior to the adoption of the new registration rules, FBOTs were permitted to offer direct market

access to their US members or participants by obtaining a "no-action" letter from the Division of Market Oversight (DMO). For many years, DMO administered the no-action process informally, but since 2006, has done so under a formal CFTC Policy Statement.⁶ The Policy Statement required that an FBOT demonstrate that it is a bona fide foreign board of trade and that granting the requested no-action relief is in the public interest and detailed the information that must be included by the FBOT in its demonstration. The Policy Statement further provided that the staff require enhanced information-sharing arrangements and surveillance procedures, or impose other conditions to address the trading of products on an FBOT under no-action relief that: adversely affect the pricing of contracts traded on a US market; create unacceptable systemic risks to the US financial system, or facilitate abusive trading practices on US markets.⁷ At present, more than 20 FBOTs operate under no-action relief.

IV. Applications For Registration

An application for registration by an FBOT wishing to enable US members or participants directly to access the FBOT's market requires the submission of information using a specified form with specific substantive and formatting requirements. Form FBOT and Form S-1 (for the FBOT's clearing organization) require that the applicant demonstrate the comparable and comprehensive nature of its home country regulatory framework by providing narrative discussions and specified supporting documents.⁸ These include information and documentation on both the FBOT's and its clearing organization's membership criteria, trading system, contracts, settlement and clearing process, rules and rule enforcement process, and information-sharing arrangements.⁹ The applicant must also provide information relating to the governing home regulatory regime—the FBOT's home country regulator must oversee the FBOT for customer and market protections and have authority to intervene in the market. The FBOT's home country regulator must also be able to share information with the Commission and is required to have entered into satisfactory information-sharing agreements with the Commission.¹⁰

Once registered, FBOTs are also subject to ongoing regulatory conditions, including: remaining in compliance with home regulations, maintaining appropriate information-sharing arrangements, remaining in compliance with IOSCO Principles for the Oversight of Screen-Based Trading Systems for Derivative Products, and clearing all direct-access products through a derivatives clearing organization registered with the CFTC or a clearing organization that observes the Recommendations for Central Counterparties.¹¹ In addition, registered FBOTs are required to seek Commission permission to offer additional contracts for direct market access that were not submitted during the registration process and to provide ongoing information and reports to the CFTC. Finally, those FBOTs that make available contracts by direct market access to the US that are linked to the price of contracts traded on a US market will be subject to a number of additional regulatory requirements, including enhanced reporting and market surveillance responsibilities.¹²

V. No Grandfathering

Despite the Dodd-Frank Act's requirement that the Commission take into consideration a previous finding that an FBOT operates under a comprehensive, comparable regulatory scheme, the rules do not grandfather those FBOTs with existing no-action relief.¹³ Rather, the Commission has included a

"limited application" process for those FBOTs operating under no-action relief. Under the limited application process, qualifying FBOTs must complete the full Forms FBOT and S-1, but may rely on and incorporate by reference previously submitted materials. However, FBOTs with existing no-action relief that file their registration applications within 180 days will be able to continue to operate under their existing relief while their applications are pending review.

VI. Conclusion

All FBOTs that currently permit, or that in the future wish to permit, direct access to their electronic trading and order matching systems from the US will be required by the CFTC's recently adopted rules to apply for registration. The required demonstration is similar to that of the prior no-action process, but with greater specificity and detail. Although all FBOTs with existing direct access from the US should qualify under the new registration rules, they must take care to meet the CFTC's new procedural requirements to ensure that access by their US members or participants is uninterrupted.

¹ By Paul M. Architzel, Partner, and Bruce B. Fekrat, Special Counsel, WilmerHale. The authors may be contacted at: paul.architzel@wilmerhale.com (+1 202 663 6240) or bruce.fekrat@wilmerhale.com (+1 202 663 6641), respectively.

²See "Registration of Foreign Boards of Trade," 76 *Fed. Reg.* 80674 (December 23, 2011) ("FBOT Rules").

³Pub. L. No. 111-203, 124 Stat. 1376 (2010).

⁴ See Dodd-Frank Reform Act § 738(a) (stating 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").

⁵See *id.*

⁶See "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 *Fed. Reg.* 64443 (November 2, 2006) ("Policy Statement").

⁷*Id.* at 64449.

⁸ 17 CFR 48.5.

⁹ 17 CFR 48.7.

¹⁰*Id.*

¹¹ 17 CFR 48.8. Commission regulation 48.2 defines "Recommendations for Central Counterparties" to mean (1) the current Recommendations for Central Counterparties issued jointly by the Committee on Payment and Settlement Systems and the Technical Committee of the International Organization of Securities Commissions as updated, revised or otherwise amended, or (2) successor standards, principles and guidance for central counterparties or financial market infrastructures adopted jointly by the International Organization of Securities Commissions and the Committee on Payment and Settlement Systems. 17 CFR 48.2.

¹² These include: (1) making public certain daily trading information for linked contracts; (2) adopting position limits; (3) having the authority to require or direct any market participant to limit, reduce or liquidate any position; (4) agreeing to promptly notify the Commission of certain changes with respect to the linked contract; (5) providing information to the Commission regarding large positions; (6) informing the Commission in a quarterly report of any member that had positions above the applicable FBOT position limit; (7) providing trade execution and audit trail data for the CFTC's Trade Surveillance System; (8) providing, at least one day prior to the effective date, copies of, or hyperlinks to, all rules, rule amendments, circulars and other notices published by the FBOT with respect to all linked contracts; (9) providing copies of all disciplinary notices involving the FBOT's linked contracts; and (10) promptly taking similar action with respect to linked contract in the event that the CFTC directs the related US registered entity to take emergency action with respect to such a contract (e.g., to reduce positions in or cease trading in the contract).

¹³ 17 CFR 48.6.

Authors



Paul M. Architzel

RETIRED SENIOR
COUNSEL

☎ +1 202 663 6000