

# Client Alert

Special Matters & Government Investigations Practice Group

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## FinTech Fraternization: CFTC and NFA Announce Cross-Border Collaboration Agreement

Nearly a year after then-acting US Commodity Futures Trading Commission (CFTC) Chairman J. Christopher Giancarlo<sup>i</sup> actively promoted FinTech innovation as a key to economic growth, he has minted a groundbreaking FinTech collaboration arrangement with the UK Financial Conduct Authority (FCA). The Arrangement, signed on February 19, is the first FinTech agreement for the CFTC with a foreign equivalent. It is intended to facilitate information sharing, collaboration, and support of the CFTC and FCA's FinTech initiatives, and will also facilitate referrals of FinTech companies interested in entering different markets.<sup>ii</sup>

Much like his enthusiastic embrace of FinTech indicated in speeches in March 2017, January 2017, and September 2016, Chairman Giancarlo's public comments on the Arrangement alluded to the need for regulators to be forward-thinking and adapt to the pace of digital markets.

The FCA's Project Innovate is the gold standard for thoughtful regulatory engagement with emerging technological innovation. Therefore, I am delighted to join Andrew Bailey in this arrangement to demonstrate our cross-Atlantic commitment to facilitating market-enhancing innovation and sharing best practices in FinTech engagement. This is the first FinTech innovation arrangement for the CFTC with a non-US counterpart. We believe that by collaborating with the best-in-class FCA FinTech team, the CFTC can contribute to the growing awareness of the critical role of regulators in 21st century digital markets. Our LabCFTC FinTech effort grew out of a bipartisan commitment to innovation.

FCA Chief Executive Andrew Bailey focused on the proactive, productive use of FinTech for firms. "As our first agreement of this kind with a U.S. regulator, we look forward to working with LabCFTC in assisting firms, both here in the UK and in the U.S., who want to scale and expand internationally in our respective markets."

### *LabCFTC and Innovate – A Refresher*

The Arrangement is focused on the respective FinTech initiatives promoted by the two agencies – the CFTC's "LabCFTC" and the FCA's "Innovate." LabCFTC, which was launched in May 2017,<sup>iii</sup> is the focal point for the

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CFTC's efforts to promote responsible FinTech innovation and fair competition for the benefit of the American public.<sup>iv</sup> A dedicated CFTC function to engage with new technologies, LabCFTC is intended to be the hub of engagement for the FinTech community. Currently, the Lab hosts meetings with FinTech innovators and releases FinTech primers intended to educate the market on emerging FinTech innovations and technologies; serves as an information source for the Commission and CFTC staff on responsible innovation as a potential policy influencer; and promotes FinTech innovation through a variety of mechanisms. LabCFTC also has a communication-oriented arm, GuidePoint, which provides FinTech innovators a channel to obtain feedback and inform the CFTC of relevant content to facilitate or enhance FinTech development. Finally, LabCFTC uses its core program "CFTC 2.0" to help initiate the adoption of new technology within its own mission through collaboration with FinTech firms and market participants. This iterative, communicative approach enables the CFTC to actively monitor areas that may require regulatory action to keep pace with technological advances.

The FCA's Innovate has had significantly more time to ramp up and engage with international firms after launching much earlier in October 2014.<sup>v</sup> In fact, in March 2017, Chairman Giancarlo addressed a perceived lag by the CFTC and other US regulators in promoting FinTech when compared to UK regulators by noting the importance of the CFTC identifying the appropriate role for it to play in promoting US FinTech innovation in Commission regulated markets. Innovate, a hub which allows FinTech firms to test and develop products through its "Regulatory Sandbox," also permits the FCA to keep tabs on regulatory-appropriate technology organically. But this kind of regulatory innovation, however effective, initially faced opposition in the United States.

In addition to the Sandbox, Innovate also allows direct support requests by firms, and has a dedicated Advice Unit – similar to LabCFTC's GuidePoint – where the FCA provides feedback. Innovate has accommodated all kinds of firms ranging from start-ups to established mega-participants in their multiple Sandbox phases, a tactic which has theoretically allowed them to "level[] the playing field" by lowering the barriers for firms to bring products to the financial markets.<sup>vi</sup>

### *Implications For Market Participants and Counsel*

Although the 8-page Arrangement is mostly high-level, containing a host of definitions, general provisions, descriptions, and boilerplate language, there are certain items of particular note. First, in the Arrangement, the FCA and CFTC have agreed – subject to applicable domestic laws and regulations – to share information related to FinTech or efficient regulation and oversight of financial markets and participants (RegTech), including information on "Innovator Businesses" and "[a]ctivities of domestic and international organizations or bodies that promote innovation in FinTech and RegTech." This officially-mandated information sharing is meant to promote open communication and further dialogue between the global financial industry and regulators, but it may also lead to additional regulation on the basis of demonstrated international FinTech trends. Although regulators routinely share information, the Arrangement sets forth a formulated process of cross-border information sharing about market participants.<sup>vii</sup> This information flow about developments could also be potentially problematic for FinTech firms on the bounds of existing regulation, or possibly subject to new regulation, as any questionable technical developments would be visible in real-time to the regulators.

Additionally, the Arrangement provides for a seamless mechanism of referral of Innovator Businesses from LabCFTC to Innovate, or vice versa. This allows the foreign entity to participate in the counterpart's FinTech program and further permits the CFTC and FCA to share information about technical developments that could spur regulatory review.

The Arrangement further evidences the CFTC's embrace of what had previously been the purview of the UK – active management and observation of the product development processes along with accompanying authority over the ultimate functional product. Judging from Chairman Giancarlo's public statements, he approves of this kind of collaborative governance between the public (the financial industry and market participants) and regulators. Notably,

the Arrangement also promotes the most active kind of regulatory engagement. Specifically, the Arrangement outlines a mechanism of “Support for Innovator Businesses” which goes so far as to designate a contact person for each Innovator Business,<sup>viii</sup> offer assistance to that business in understanding the applicable regulatory framework during the pre-Authorization application phase, grants support during the Authorization process, and provides assistance with ongoing inquiries.

## *The CFTC’s Continued Embrace of Technology*

The Arrangement is further indication that Chairman Giancarlo and the CFTC are actively seeking to engage with the financial industry, following the lead of UK regulators, and continually seeking out opportunities to keep pace with the digital markets. In March 2017, Chairman Giancarlo outlined a “forward-looking agenda” for the CFTC to “support[] America’s vital national interest in maintaining the world’s deepest, most durable and most vibrant capital and risk transfer markets in the algorithmic, digital world of the 21<sup>st</sup> [C]entury.”<sup>ix</sup> His agenda covered leveraging FinTech innovation, the previously discussed role of the CFTC in promoting FinTech, and using FinTech innovation to help identify CFTC rules and regulations that need updating for 21<sup>st</sup> Century digital markets. The Arrangement enables Chairman Giancarlo to support all three of those goals. Further, the Arrangement allows for exposure to a host of firms (and corresponding FinTech developments) previously known only to the FCA and UK authorities.

Although the Arrangement is framed as a proactive approach to assisting FinTech firms in developing their businesses, it is also an easy mechanism for practical CFTC research, observation, and policymaking.<sup>x</sup> Chairman Giancarlo’s approach to modernization appears ambitious, but the Arrangement will expand the resources available to the CFTC in its quest to modernize the regulatory environment in response to the rapid pace of FinTech advances.

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*This alert provides a general summary of recent legal developments. It is not intended to be and should not be relied upon as legal advice. In some jurisdictions, this may be considered “Attorney Advertising.”*

<sup>i</sup> Giancarlo was nominated Chair of the CFTC in March 2017, and confirmed on August 3, 2017.

<sup>ii</sup> CFTC-FCA ARRANGEMENT ON FINANCIAL TECHNOLOGY INNOVATION (February 19, 2018), available at

<http://www.cftc.gov/idc/groups/public/%40internationalaffairs/documents/file/cftc-fca-cooparrgt021918.pdf>. According to the text of the Arrangement, the parties reached this agreement “in order to enhance mutual understanding, identify market developments and trends, facilitate innovation with respect to financial technology, and foster the use of technology for more effective and efficient regulation and oversight of financial markets and participants.”

<sup>iii</sup> LabCFTC has engaged with over 150 entities since its launch last year, published its first primer on the topic of virtual currencies, and soon will seek public feedback on a planned 2018 innovation competition.

<sup>iv</sup> See CFTC, *CFTC Launches LabCFTC as Major FinTech Initiative*, May 17, 2017, available at <http://www.cftc.gov/PressRoom/PressReleases/pr7558-17>.

<sup>v</sup> See FCA Innovate, 2014, available at <https://www.fca.org.uk/firms/fca-innovate>. To date, the FCA’s Innovation Hub has supported over 500 businesses and the authorization of 43 businesses.

<sup>vi</sup> See FCA, *Innovation Hub Now Open for Business, says FCA*, October 28, 2014, available at <https://www.fca.org.uk/news/press-releases/innovation-hub-now-open-business-says-fca>. In these comments, FCA Chief Executive Martin Wheatley noted: “This work levels the playing field by giving all firms eager to innovate access to our expertise so that the process of joining the financial markets or introducing new products does not seem so daunting.”

<sup>vii</sup> The Arrangement’s Article five covers Confidentiality and mandates that the CFTC and FCA must keep non-public information confidential. Exceptions include information sharing with prior written consent, and a specific provision stating that the Requesting or Receiving Authority intends to notify the other of any legally enforceable demand for the non-public information at issue. The arrangement also notes that non-public information sharing or disclosure that is prepared by or on behalf of the CFTC or FCA, pursuant to the terms of the Arrangement, will not constitute a waiver of privilege or confidentiality.

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<sup>viii</sup> Innovator Business is defined in the Arrangement as “an entity or individual that has been offered, or that would qualify for, support as described in Paragraph 19 from an Authority [the CFTC or FCA] through its Innovation Function [LabCFTC or Innovate].” Although the Arrangement does not offer additional color on the qualifications of an Innovator Business, past LabCFTC and Innovate participating Innovator Businesses have ranged from start-ups to established FinTech firms.

<sup>ix</sup> CFTC, *Address of CFTC Commissioner J. Christopher Giancarlo to the American Enterprise Institute*, September 21, 2016, available at <http://www.cftc.gov/PressRoom/SpeechesTestimony/opagiancarlo-17>.

<sup>x</sup> To date under Chairman Giancarlo’s watch, the CFTC has made only one substantive change to its rules, in the form of amendments to the recordkeeping requirements to Regulation 1.31. The amendments, proposed in January 2017 and unanimously approved in May, modify definitions to provide more clarity and strike obsolete terms; change the duration, form, and manner of record retention; amend production requirements based on form; add a new section revising ongoing compliance obligations with respect to written regulatory records and procedures; and remove other outdated provisions like references to CD-ROMs. (*See* 17 C.F.R. § 1.31). There are several outdated CFTC regulatory requirements – some mention stale technology like facsimile, (*see* 17 C.F.R. § 5.16 which requires written “facsimile” notice), and others have been deemed “biased against technological innovation” by Chairman Giancarlo himself. *See* CFTC, *Remarks of Acting Chairman J. Christopher Giancarlo before the 42nd Annual International Futures Industry Conference in Boca Raton, FL*, March 15, 2017, available at <http://www.cftc.gov/PressRoom/SpeechesTestimony/opagiancarlo-20>. Giancarlo was referring specifically to the CFTC’s swaps trading regulatory framework.