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The Return of Security Futures: What CME's Single Stock Futures Mean for Broker-Dealers and FCMs

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For the better part of two decades, security futures in the United States have been less a living product than a regulatory artifact. The category was first conceived in the Shad-Johnson Accord between the Securities and Exchange Commission (SEC) and Commodity Futures Trading Commission (CFTC) in 1982 and was then given legal life by the Commodity Futures Modernization Act (CFMA) in 2000. Even so, security futures struggled, for many reasons, to find a foothold in US financial markets. Notwithstanding the laborious efforts of SEC and CFTC staff to create a co-jurisdictional framework for security futures, exchanges were slow to list, and investors were mostly indifferent. Since OneChicago's closure in September 2020, security futures have not traded on a futures or securities exchange in the United States. Security futures, it seemed, existed in legal taxonomy, but no longer in commerce.

But that is about to change. CME has announced plans to launch, before the end of this month, cash-settled futures on individual shares of common stock (the first listing of security futures on a CME exchange since 2011). The launch involves futures contracts on 55 individual equity names, covering between 55 and 65 percent of the S&P 500 and Nasdaq-100 by weighting.

Security futures are, by statutory definition, both securities and futures and are therefore regulated by both the SEC and the CFTC. This dual character creates a web of overlapping and sometimes conflicting compliance obligations for the broker-dealer (BD)/futures commission merchant (FCM) intermediaries that facilitate customer transactions in them. BD/FCMs must navigate a complex terrain of dual registration requirements, account-type determinations, parallel margin regimes, duplicative supervisory rules, and layered self-regulatory obligations.

Two-Headed Regulation: SEC/CFTC Joint Jurisdiction

The regulatory architecture governing security futures is, by design and by history, complex. For most of the modern era of derivatives regulation, futures on individual equity securities were effectively prohibited under US law. The Shad-Johnson Accord memorialized a jurisdictional compromise between the SEC and CFTC: broad-based index futures would fall under the CFTC's exclusive jurisdiction. In contrast, futures on single names and narrow-based security indices were simply barred from trading.

The CFMA reversed that prohibition by amending both the Commodity Exchange Act (CEA) and the Securities Exchange Act (Exchange Act) to permit trading of futures and options on futures on individual equity securities and narrow-based security indices — collectively termed "security futures products" in the statute. The CFMA directs the SEC and CFTC to share oversight through limited cross-licensing of exchanges and intermediaries and through joint rulemaking on key matters such as margin. Because a security future is simultaneously a security under the Exchange Act and a futures contract under the CEA, any board of trade, exchange or intermediary dealing in security futures is potentially subject to both the full securities regulatory regime and the full futures regulatory regime. Without harmonization, it would seem designed to produce duplicative and burdensome results for registrants.

The CFMA's Cross-Licensing Solution

The CFMA addresses potential duplication through a cross-licensing mechanism. A CFTC-registered designated contract market (DCM) that wishes to list security futures may notice-register with the SEC as a national securities exchange under Section 6(g) of the Exchange Act. This streamlined process does not require full compliance with all Exchange Act provisions normally applicable to national securities exchanges. Conversely, a national securities exchange that wishes to list security futures may notice-register as a DCM with the CFTC under Section 5f of the CEA.

A DCM that notice-registers with the SEC is exempt from many Exchange Act provisions, including those governing exchange governance, membership, fees, and discipline (Section 6); hypothecation rules (Section 8); principal trading restrictions (Section 11); and various recordkeeping and self-regulatory organization (SRO) provisions (portions of Sections 17 and 19). However, it must still submit certain rules to the SEC for approval, including listing standards and margin rules, and the only securities it may trade are security futures products.

For the exchanges, cross-licensing reduces (though it does not eliminate) regulatory overlap. For the intermediaries (i.e., the BDs and FCMs that will transact in these products on behalf of customers), the picture is more complex. Because a security future is defined as both a security and a future, an intermediary that deals in security futures may need to be registered with both the SEC (as a BD) and the CFTC (as an FCM), and may be subject to the rules of both the Financial Industry Regulatory Authority (FINRA) and the National Futures Association (NFA).

Compliance Challenges for BD/FCMs

The dual regulatory character of security futures creates compliance challenges for BD/FCMs.

Dual Registration

The CFMA also provides a streamlined path for firms whose securities activities are confined to security futures. Under Section 15(b)(11) of the Exchange Act, a firm already registered with the CFTC as an FCM (or introducing broker) whose securities activities are limited to security futures may register with the SEC as a BD by notice rather than through the full Form BD application process. This notice-registered BD is subject to certain conditions, including membership in a limited-purpose national securities association registered under Section 15A(k) of the Exchange Act. The NFA serves as that limited-purpose national securities association; accordingly, a notice-registered BD need not become a FINRA member. Notice-registered BDs are exempt from various Exchange Act provisions, including Sections 8, 11, portions of 15(c), 15B, and 15C, and portions of Section 17.

Conversely, a firm that is fully registered as a BD with the SEC and FINRA and wishes to trade security futures in its capacity as a futures intermediary would need to register (or be notice-registered) as an FCM or introducing broker with the CFTC.

In practice, most major firms active in both equity and futures markets hold full registrations as both a BD and FCM. But for firms entering this space for the first time, or for firms currently registered only on one side, the registration decision has important downstream consequences for which compliance regime governs their security futures activities.

Account Type Determines the Regime (Mostly)

The compliance regime for an intermediary's security futures activities turns not just on the firm's registration status, but critically as well on the account to which the intermediary books a customer's security futures positions. Whether a customer's security futures are held in a futures account or a securities account determines which customer asset protection regime (CFTC segregation or Exchange Act customer protection) applies, as well as whether (and to what extent) the firm is subject to FINRA's or NFA's rules relating to security futures.

Industry practice, universally among both fully registered and notice-registered BDs that are also registered FCMs or IBs, is to carry security futures in the customer's futures account. This means, for fully registered BD/FCMs, that their security futures activities are subject to FINRA's (rather than the NFA's) security futures rules; for notice-registered BD/FCMs, it means that their security futures activities are subject to the NFA's security futures rules (and not FINRA's). But this seeming symmetry is subject to an important qualification; fully registered BD/FCMs are full members of the

NFA (and therefore their security futures activities remain in scope of the NFA's general futures oversight over its members); notice-registered BD/FCMs are *not* members of FINRA (and therefore, FINRA has no jurisdiction over their activities).

In addition, FINRA-member fully registered BD/FCMs are subject not just to FINRA rules specific to security futures. As FINRA members, they are also subject to *all* FINRA By-Laws and rules, interpretations and policies (including the requirement to comply with applicable securities laws and SEC regulations, many of which touch on obligations that are subject to analogous By-Laws, rules, interpretations and policies applicable to that FINRA member as a member of the NFA and a registered FCM.

Margin. Margin is among the areas where the joint regulatory framework will be most immediately visible to market participants. The Federal Reserve delegated authority over security futures margin to the SEC and CFTC through joint rulemaking. These parallel regulations establish minimum customer margin levels for security futures contracts.

Under the joint rules, the minimum customer initial and maintenance margin for an unhedged (outright) long or short security futures position is 15 percent of the contract's current market value. Strategy-based offsets, such as calendar spreads in different months of the same contract, permit lower margins, with a floor of 5 percent of the current market value of the higher-value leg. Section 7(c)(2)(B) of the Exchange Act requires that security futures margin levels be consistent with comparable listed options margin and no lower than the lowest margin for comparable exchange-traded options.

An Inventory of Overlapping Regulatory Requirements

Account Opening, Suitability and Disclosure. Both the securities and futures regimes impose account-opening and disclosure requirements on intermediaries dealing in security futures. The requirements are not identical, and firms operating under one regime should not assume compliance with the other.

Account opening and know-your-customer. FINRA Rule 2370(b)(16) requires a BD that effects security futures transactions to exercise due diligence to ascertain the essential facts about each customer, including the customer's financial situation and investment objectives, with enhanced verification for natural-person customers. Account agreements must include mandatory provisions addressing position limits. A designated security futures principal must approve accounts. FINRA Rule 2090 (know-your-customer) applies in parallel. For notice-registered BDs, NFA Compliance Rule 2-30 imposes analogous requirements, with additional information collection for individual customers and annual verification of customer information.

Suitability. FINRA Rule 2370(b)(19) and FINRA Rule 2111 require a BD to have a reasonable basis to believe that a recommended security futures transaction or strategy is suitable for the customer, taking into account the customer's investment profile (age, financial situation, tax status, investment objectives, experience, time horizon, liquidity needs, and risk tolerance). Suitability determinations must be refreshed at least every 36 months (as required by Exchange Act Rule 17a-3(a)(17)(i)(D)). NFA Compliance Rule 2-30(j)(4) imposes a parallel obligation for notice-registered BDs.

Risk disclosure. FINRA Rule 2370(b)(11) requires delivery of the current security futures risk disclosure statement to each customer prior to the first security futures transaction in the account. NFA Compliance Rule 2-30(b) imposes a parallel requirement for notice-registered BDs. The standardized "Risk Disclosure Statement for Security Futures Contracts" (jointly developed by FINRA and NFA) must be provided regardless of the customer's status (as retail or institutional).

Proficiency requirements. FINRA Rule 1220.02 requires registered representatives and principals who engage in security futures activities to complete a Firm Element continuing education program on security futures (per FINRA Rule 1240). NFA Compliance Rule 2-7 requires each notice-registered member to designate at least one "designated security futures principal" who has passed the NFA Branch Manager Examination, and NFA Interpretive Notice 9049 mandates approved security futures training programs.

Promotional communications and advertising. FINRA Rule 2215 requires that retail communications concerning security futures be filed with FINRA's Advertising Regulation Department at least 10 business days before first use (with limited exceptions under Rule 2210(c)(2)(B)). NFA Compliance Rule 2-29 requires that promotional material concerning security futures meet the substantive standards of Rule 2-29(j) and be approved by a designated security futures principal; NFA Interpretive Notice 9043 adds specific requirements for disclosure of material conflicts of interest. A firm subject to both regimes must ensure that its security futures marketing materials satisfy both FINRA's pre-use filing requirement and the NFA's approval and disclosure standards.

Supervision and written supervisory procedures. As noted, FINRA Rule 2370 applies FINRA's full supervisory apparatus to security futures trading by its members. NFA Compliance Rule 2-37 bars violations of Exchange Act Sections 9(a), 9(b), and 10(b) in connection with security futures and requires notice-registered BDs to adopt, maintain, and enforce written supervisory procedures reasonably designed to achieve compliance with applicable securities laws. Dual registrants must maintain written supervisory procedures that address both FINRA and NFA requirements—an exercise in reconciliation, given that the two frameworks, while parallel in purpose, differ in specifics.

Best execution. FINRA Rule 5310 (best execution) applies to fully registered BDs. NFA Interpretive Notice 9048 establishes a parallel best-execution standard for notice-registered BDs.

Discretionary accounts. FINRA Rule 3260 governs discretionary account trading for fully registered BDs; NFA Rule 2-8 establishes parallel requirements for futures accounts. Trading ahead prohibitions apply under FINRA Rule 2370(b)(25).

Market Access. Exchange Act Rule 15c3-5 applies to security futures products traded on an exchange or an ATS for fully registered BDs, but not for notice-registered BDs that are not subject to the customer asset protection requirements of Exchange Act Rule 15c3-3. The CFTC regulations and NFA compliance rules include provisions requiring that FCMs to set limits on accounts and to supervise customer access to exchanges but nothing precisely analogous to Rule 15c3-5.

Fair pricing. FINRA Rule 2121 (fair prices and commissions) applies to fully registered BDs; NFA Compliance Rule 2-37(g) establishes an analogous standard. Both require that commissions and charges be fair and reasonable.

Recordkeeping. FINRA Rule 2370(b)(17) and Rule 4511 impose recordkeeping requirements on fully registered BDs. Exchange Act Rule 17a-3(e) provides an important carve-out: the Rule 17a-3 recordkeeping requirements do not apply to security futures held in a futures account. NFA Compliance Rule 2-37(f) covers complaint reporting for notice-registered BDs.

Anti-fraud and anti-manipulation. The Exchange Act's general anti-fraud prohibition (Section 10(b) and Rule 10b-5) applies to security futures. The SEC's anti-manipulation authority under Section 9 is reserved, and Section 9(h)(2) also reserves SEC jurisdiction over manipulation involving security futures. Notably, however, Section 10(b) short-sale anti-fraud regulation does not apply to security futures products.

Insider reporting. Section 16(f) of the Exchange Act extends insider disclosure requirements to transactions involving security futures. Corporate insiders (officers, directors, and 10 percent beneficial owners) must report security futures positions and transactions in the underlying equity.

Reg NMS and large trader reporting. Security futures are not NMS securities within the meaning of SEC Rule 13h-1 and Regulation NMS. Accordingly, Reg NMS trade-through, access, and sub-penny rules do not apply. The CFTC's large trader rules under Parts 15 and 17 of the CFTC regulations do apply to FCMs holding security futures as futures.

Form CRS. Fully registered BDs must deliver Form CRS (the “Customer Relationship Summary” required by Exchange Act Rule 17a-14) to retail investors; notice-registered BDs that are FCMs are subject to broadly analogous CFTC disclosure requirements under CFTC Rule 1.55.

Key Takeaways for BD/FCMs

For BDs, FCMs, and dual registrants preparing for CME's launch, the following practical considerations merit immediate attention:

1. **Confirm registration eligibility of security futures principals and AP/registered representatives.** There are various paths under NFA and FINRA rules to qualify as a security futures principal or broker (associated person/registered representative). BD/FCMs will need to establish a process for approval of new and existing customer security futures accounts by a security futures principal.
2. **Review margin procedures.** For most customer accounts, the strategy margin requirements under FINRA Rule 4210 (reproduced under revised CME Rule 930.C) will apply (subject to a firm's election of portfolio margining for eligible customers). Firms should ensure that their margin systems can calculate and collect performance bonds for security futures at the required levels.
3. **Update compliance infrastructure.** Firms will need to update written supervisory procedures, compliance manuals, and training programs to address security futures. This includes designating qualified security futures principals, updating promotional-material review workflows to satisfy both FINRA and NFA standards, ensuring delivery of the standardized risk disclosure statement, and implementing appropriate onboarding and suitability procedures.
4. **Reconcile duplicative obligations.** Dual registrants may face parallel requirements from FINRA and NFA on proficiency, advertising, supervision, best execution, and recordkeeping.

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An FAQ on the CME security futures offering is available here. The CME's Security Futures Product Rule Submission with the CFTC is available here; the SEC's order approving those rules is available here. A summary of FINRA and NFA paths for qualifying as a security futures principal or broker is available here.

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