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CFTC & NFA Developments for CPOs, CTAs & Other Asset Managers

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NEW AND DEVELOPING FEDERAL REGULATION

CFTC Adopts Clearing Requirement for Interest Rate Swaps in Nine Currencies

On September 28, 2016, the U.S. Commodity Futures Trading Commission (CFTC) expanded the existing clearing requirement for interest rate swaps.[1] The expanded interest rate swap classes include fixed-to-floating interest rate swaps denominated in Australian dollars, Canadian dollars, Hong Kong dollars, Mexican pesos, Norwegian kroner, Polish zloty, Singapore dollars, Swedish kronor, and Swiss francs; basis swaps denominated in Australian dollars; forward rate agreements denominated in Norwegian kroner, Polish zloty and Swedish kronor; and overnight index swaps denominated in Australian dollars and Canadian dollars, as well as U.S. dollar-, euro-, and sterling-denominated overnight index swaps with termination dates up to three years. The CFTC had also proposed mandatory clearing for forward rate agreements denominated in Australian dollars, but did not include them in the final rulemaking. The clearing requirement applies to swaps currently cleared by four registered derivatives clearing organizations (DCOs): Chicago Mercantile Exchange Inc., Eurex Clearing AG, LCH.Clearnet Ltd. and Singapore Exchange Derivatives Clearing Ltd. Four other DCOs that the CFTC has exempted from registration — ASX Clear (Futures) Pty Ltd., Japan Securities Clearing Corp., Korea Exchange Inc. and OTC Clearing Hong Kong Ltd. — are eligible to clear interest rate swaps subject to the expanded clearing requirement, but only for U.S. proprietary accounts.

The clearing requirement will apply to all market participants entering into any of the above-listed swaps, except where the market participant qualifies for an exception (such as the end-user exception) or exemption (such as the inter-affiliate exemption). Unlike the CFTC's initial clearing requirements, this requirement will not follow a phased-in compliance schedule by market participant. Rather, compliance will be phased in according to an implementation schedule based on when analogous clearing requirements have taken, or will take, effect in non-U.S. jurisdictions. There is a two-year time limit on this phasing schedule to provide certainty to market participants. In taking this approach, the CFTC stated that it believes it is important to account for non-U.S. jurisdictions' timelines for mandating clearing when imposing a compliance date for U.S. market participants.

Proposed Amendments to Rule 3.10(c): Exemption From Registration for Certain Foreign Intermediaries

On July 27, 2016, the CFTC proposed amendments to CFTC Regulation 3.10(c) that would amend the conditions under which persons located outside the United States acting in the capacity of a futures commission merchant (FCM), an introducing broker (IB), a commodity trading advisor (CTA) or a commodity pool operator (CPO)

in connection with commodity interest transactions solely on behalf of persons located outside the United States, or on behalf of certain international financial institutions (IFIs) (such persons collectively referred to as Foreign Intermediaries),[2] would qualify for an exemption from registration with the CFTC.[3] Currently, CFTC Regulation 3.10(c) provides an exemption from registration for Foreign Intermediaries engaging in commodity interest transactions solely on behalf of persons located outside the United States if such commodity interest transactions are submitted for clearing at a DCO through a registered FCM. The CFTC proposed to amend CFTC Regulation 3.10(c)(2)(i) and (3)(i) in tandem to simplify the registration exemption that is available to Foreign Intermediaries. Specifically, the proposed amendments would permit a Foreign Intermediary to be eligible for an exemption from registration if the Foreign Intermediary, in connection with a commodity interest transaction, acts only on behalf of (1) persons located outside the United States, or (2) IFIs (as defined in the proposed amendments), without regard to whether such persons or institutions clear such commodity interest transactions. However, the CFTC clarified that removing the clearing requirement from the conditions of the regulation does not excuse any person from compliance with any requirement that a commodity interest transaction be cleared by a DCO registered with the CFTC, or exempt from registration. Persons located outside the United States who are subject to any applicable clearing requirement for futures or swaps, or any other applicable provision of the CEA or CFTC regulations, must comply with those requirements regardless of any registration exemption for a Foreign Intermediary.

The proposed amendments codify relief provided in two prior no-action letters issued by the CFTC's Division of Swap Dealer and Intermediary Oversight (DSIO) in 2015 and 2016 that permitted Foreign Intermediaries to rely on the exemption in CFTC Regulation 3.10(c)(3)(i) if their activities involved swaps that are not subject to a CFTC clearing requirement.[4] In the 2016 no-action letter, the DSIO noted that the Commodity Exchange Act (CEA) and CFTC regulations do not require that all swaps be cleared and some swaps are not yet accepted for clearing. Thus, the DSIO stated that the CFTC did not intend that Foreign Intermediaries acting only for persons located outside the United States be required to register if the intermediaries merely acted for such persons in connection with transactions not required to be cleared under the CEA or CFTC Regulation. In the 2015 no-action letter, the DSIO provided relief from IB or CTA registration for intermediaries acting for IFIs that may have headquarters or another significant presence in the United States, in recognition of the fact that the unique attributes and multinational status of IFIs did not warrant treating them as domestic persons.

Comments to the proposed amendments were due September 6, 2016.

Proposed Amendments to CPO Annual Report Requirements in CFTC Regulation 4.22

On August 5, 2016, the CFTC proposed amendments to CFTC Regulation 4.22, which currently requires a registered CPO to distribute to each participant in each commodity pool that it operates and to submit to the National Futures Association (NFA) an annual report for the pool (Annual Report) within 90 calendar days after the end of the pool's fiscal year.[5] The proposed amendments would permit financial statements in the Annual Report to be presented and computed using accounting principles, standards or practices followed in the United Kingdom, Ireland, Luxembourg or Canada. The proposed amendments would also provide an exemption from the audit requirements applicable to the Annual Report for a pool's first fiscal year when the period from formation of the pool to the end of the pool's first fiscal year is a short period of time. Finally, the CFTC's proposed amendments would seek to ensure that an audit is conducted at least once in the life of a commodity pool.

CFTC Regulation 4.22(d) specifies how the financial statements in the Annual Report must be presented and computed. Currently, paragraph (d)(1) requires that the financial statements must be presented and computed in accordance with generally accepted accounting principles, and paragraph (d)(2) makes available an exception to this requirement by permitting the use of Internal Financial Reporting Standards (IFRS) where certain criteria are met. The CFTC staff has been granting relief on a case-by-case basis to allow registered CPOs operating commodity pools outside the United States to use accounting standards established in certain other jurisdictions. The CFTC believes that the staff's experience in granting relief to use the accounting principles, standards or practices of certain other jurisdictions warrants extending relief comparable to that which CFTC Regulation 4.22(d)(2) provides for the use of IFRS. Accordingly, the CFTC proposed amendments to CFTC Regulation 4.22(d)(2) so that it would also permit the use of generally accepted accounting principles, standards or practices followed in the United

Kingdom, Ireland, Luxembourg or Canada. A CPO seeking to avail itself of any of these additional alternative accounting principles, standards or practices would be required to claim the relief by filing a notice with the NFA containing the same representations required for CPOs desiring to use IFRS.[6]

CFTC Regulation 4.22(g) governs the election of a fiscal year by a CPO. The CFTC proposes to amend Regulation 4.22(g)(2) to provide an exemption from the audit requirement applicable to the Annual Report for a pool's first fiscal year when the period from formation of the pool to the end of the pool's first fiscal year is a short period of time. The proposed exemption would specify the criteria for eligibility and the procedure to be followed to claim the exemption. A CPO claiming the exemption would be subject to compliance with the condition that the next Annual Report the CPO distributes and submits is audited and covers the time period from the formation of the pool to the end of the pool's first 12-month fiscal year. A CPO would be able to claim the relief where: (i) the time period from the formation of the pool to the end of the pool's first fiscal year is three months or less; (ii) from the formation of the pool to the end of the pool's first fiscal year the pool had no more than 15 participants; and (iii) from the formation of the pool to the end of the pool's first fiscal year the total gross capital contributions received by the CPO for units of participation in the pool did not exceed $1.5 million. In calculating the total gross capital contributions, the following persons and their capital contributions would not be counted: (i) the pool's CPO, its CTA, and any of their principals; (ii) a child, sibling, or parent of the participants described in category (i); (iii) the spouse of any of the participants described in category (i) or (ii); (iv) any relative of one of the participants described in categories (i) through (iii); and (v) an entity that is wholly owned by one or more of the participants described in categories (i) through (iv).

CFTC Regulation 4.22(c)(7) makes available various exceptions to Annual Report requirements to the CPO of a pool that ceases operation prior to, or at the end of, the pool's fiscal year. In particular, paragraph (c)(7)(iii) provides that a report distributed and submitted pursuant to Regulation 4.22(c)(7) is not required to be audited if the CPO complies with the conditions stated in the regulation. However, to ensure that an audit is conducted at least once in the life of a commodity pool, the CFTC proposes to amend Regulation 4.22(c)(7)(iii) to make the audit requirement relief under that paragraph unavailable where a CPO has not previously distributed an audited Annual Report to pool participants or submitted the audited Annual Report to the NFA.

Comments on the proposal were due September 20, 2016.[7]

CFTC Proposes to Amend the Timing for Filing Chief Compliance Officer Annual Reports by Major Swap Participants and Certain Other Registrants

On August 9, 2016, the CFTC announced proposed amendments to CFTC Regulation 3.3, which would provide major swap participants (MSPs), FCMs and swap dealers (SDs) additional time to file chief compliance officer (CCO) annual reports and clarify the timing of the filing requirements applicable to SDs and MSPs located in jurisdictions for which the CFTC has granted a comparability determination with respect to the contents of the reports.[8] If adopted, the proposed rule would effectively codify and supersede CFTC Staff Letter No. 15-15 issued March 27, 2015.[9]

Sections 4s(k)(3) and 4d(d) of the CEA and CFTC Regulation 3.3 thereunder require CCOs for MSPs, SDs and FCMs to prepare and sign an annual report (CCO Annual Report) describing, among other things, the SD's or MSP's compliance with the CEA and CFTC regulations. CFTC Regulation 3.3(f)(2) currently requires the CCO Annual Report to be furnished to the CFTC electronically not more than 60 days after the entity's fiscal year-end. Since the adoption of the 60-day filing requirement, DSIO has continuously provided no-action relief for CCO Annual Reports submitted to the Commission within 90 days of a registrant's fiscal year-end. The proposed amendments would codify this relief.

The comment period for the proposed amendments closed on September 12, 2016.

CFTC STAFF LETTERS

No-Action Relief and Rule Interpretation Regarding the Use of Money Market Funds by FCMs and DCOs (Letters 16-68 and 16-69)

On August 8, 2016, the CFTC's Division of Clearing and Risk (DCR) and DSIO issued separate interpretative and no-action letters regarding permissible investments in money market funds by DCOs and FCMs following final implementation of the U.S. Securities and Exchange Commission's (SEC) money market reform rules.[10]

Historically, because of the daily redemption and liquidity features required under SEC Rule 2a-7, money market funds have been permitted investments under CFTC rules that strictly limit the types of instruments in which FCMs and DCOs may invest customer funds, or in which DCOs may hold certain other funds. As revised by the SEC in 2014, and with a final effective date of October 14, 2016, Rule 2a-7 requires prime money market funds to retain the authority to impose fees and gates on shareholder redemptions, and permits government money market funds to elect to do so. The August 8 letters state the CFTC's view that following implementation of these provisions, all prime money market funds and those government funds that elect to impose redemption fees and gates (electing government funds) no longer meet the necessary redemption and liquidity requirements to serve as permitted investments under the relevant CFTC rules.

The DCR letter addresses CFTC regulations under Part 39, which generally restrict the types of assets in which a DCO may hold initial margin and funds belonging to clearing members (*i.e.*, FCMs) and their customers or for certain liquidity risk management purposes, or in which a DCO designated as systemically important, or that elects to be treated as such (a systemically important DCO, or SIDCO) may hold its own funds. The DCR letter states that beginning October 14, 2016, DCR interprets Part 39 to prohibit a DCO from holding shares of a prime fund or electing government fund (1) as initial margin under Regulation 39.13(g)(10); (2) for purposes of minimizing of certain liquidity risks under Regulation 39.11(e)(1))(i); (3) for holding funds belonging to clearing members or their customer under Regulation 39.15(c); or (4) with respect to a SIDCO, for investing its own assets.

The DSIO letter addresses CFTC Regulation 1.25, which sets forth a list of permitted investments in which a DCO or FCM may invest customer funds. Permitted investments under Regulation 1.25 include interests in money market funds that meet both general and specific liquidity and redeemability conditions set forth in the rule. The DSIO letter states that when the revisions to Rule 2a-7 take effect, FCMs will no longer be permitted to invest customer funds in prime funds or electing government funds, because the liquidity fee and redemption restrictions introduced by revised Rule 2a-7 conflict with the Regulation 1.25 redemption and liquidity conditions for permitted money market fund investments. However, at the same time, DSIO provided a no-action position with respect to an FCM's investment of an amount of its own funds held in customer segregated accounts that is in excess of its targeted residual interest (a customer protection threshold set by CFTC rules) in prime funds or electing government funds, even though such funds are also subject to regulation.

DSIO stated that the FCM's holding of such excess amount in customer accounts provides a benefit to customers in the event of an insolvency of the FCM. Accordingly, DSIO will not recommend an enforcement action under Regulation 1.25 against an FCM that continues to invest its own funds held in customer segregated accounts in prime or electing government funds, provided that such funds are in excess of the targeted residual interest amount for each such account.

In addition, the DSIO letter provides no-action relief from the asset-based concentration limits conditions of Regulation 1.25 for FCMs that invest customer funds in certain government money market funds that comply with the Rule 2a-7 definition of government fund, but not the stricter Regulation 1.25 definition (Regulation 1.25 does not impose certain asset-based concentration limit on investments of customer funds in a money market fund that is comprised only of U.S. government securities, if the fund has $1 billion or more in assets and its manager has $25 billion or more in assets under management). The concentration limits no-action relief is available for investments in government funds (within the meaning of Rule 2a-7) provided that government fund is a non-electing government fund that has $5 billion or more in assets, and the fund's manager has at least $25 billion in assets under management.[11]

While these requirements and the CFTC staff's recent guidance apply to FCMs and DCOs rather than to the money market funds in which they invest, the CFTC staff positions have had a substantial impact on money market funds by requiring FCMs and DCOs to redeem all of their investments in prime funds by October 14, 2016, and reallocate those investment either to non-electing government funds to or to non- money market fund investments.

The DSIO letter raised a number of questions from FCMs about its impact on calculating targeted residual interest, the application of concentration limits, the need for a prime or electing government fund to adjust the acknowledgement letter it is required to provide in connection with FCM and DCO investments under

Regulation 1.26, and other matters. On October 18, 2016, DSIO issued a follow-up letter providing guidance on these points, including guidance that that the prime fund or electing government fund may adjust the Regulation 1.26 form acknowledgment letter to state that the fund may suspend redemptions or impose liquidity fees consistent with SEC Rule 2a-7.[12] The October 18 DSIO letter will be addressed in our quarterly review for the fourth quarter of 2016.

Portfolio Margining of Uncleared Swaps and Security-Based Swaps (Letter 16-71)

On January 6, 2016, the CFTC published final rules that impose initial and variation margin requirements with respect to uncleared swaps for SDs and MSPs that are not subject to oversight by the Prudential Regulators (Covered Swap Entities, or CSEs).[13] For more information on these requirements, refer to our quarterly review for the first quarter of 2016.[14]

On August 23, 2016, the staff of DSIO and DCR responded to a request from the International Swaps and Derivatives Association (ISDA) asking the staff to clarify whether, for the purpose of calculating initial margin for uncleared swaps, a CSE is permitted to include security-based swaps within the same product set as swaps. In response to ISDA's request, DSIO and DCR staff granted no-action relief under the CEA to CSEs that collect and post margin on a portfolio basis for swaps and security-based swaps allowing those CSEs to include security-based swaps within the same product set as swaps for this purpose, subject to certain conditions: (1) the applicable swaps and security-based swaps must be subject to the same eligible master netting agreement and netting portfolio thereunder; (2) the applicable swaps and security-based swaps must be in the same broad risk category; and (3) all security-based swaps in a netting set must be continuously and consistently included in margin calculations. The relief does not, however, affect the applicability or requirements under the rules of the Prudential Regulators, the SEC or the Financial Industry Regulatory Authority.[15]

CFTC Staff Advisory Clarifying CCO Reporting Line Requirements (Advisory 16-62)

On July 25, 2016, DSIO issued a staff advisory to clarify the requirements of CFTC Regulation 3.3 regarding CCO reporting line requirements and to address supervisory relationships that the CCO may have with senior management other than the board or the senior officer under certain circumstances.[16] CFTC Regulation 3.3 implements Sections 4d(d) and 4s(k) of the CEA by, among other things, establishing CCO reporting line requirements for SDs, FCMs, and MSPs (collectively, Registrants). According to DSIO, a number of Registrants have sought guidance regarding the practical implementation of the CCO reporting line requirements. Specifically, Registrants inquired as to whether the scope of such CCO supervisory and consultative relationships with senior management was consistent with CFTC Regulation 3.3.

Consistent with the requirement to "report directly" to the board or the senior officer in Section 4s(k)(2)(A), CFTC Regulations 3.3(a)(1) and (2) require either the board or the senior officer to: (i) appoint the CCO; (ii) approve the CCO's compensation; (iii) meet with the CCO at least annually and at the CCO's election; and (iv) make any removal decisions regarding the CCO. DSIO confirmed that additional supervisory reporting consultative relationships the CCO may have with senior management may be consistent with CFTC Regulation 3.3 and the CEA. However, when considering whether additional supervisory relationships may be appropriate, a Registrant should consider all relevant facts and circumstances, including the following: (i) under all circumstances, the reporting line requirements under CFTC Regulation 3.3(a)(1)-(2) must be satisfied and the CCO must have unfettered access to the board or the senior officer to address compliance issues; (ii) any additional supervisor should be sufficiently senior so as to provide a level of independence

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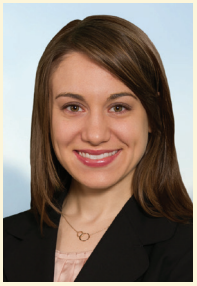

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from the risk-taking aspects of the swaps or FCM business that could otherwise create inherent conflicts when considering compliance matters; and (iii) additional supervisory senior management should be appropriate, and knowledgeable of the Registrant's regulated activities and compliance requirements.

CFTC Staff Advisory Reminding All CFTC Registrants to Comply With OFAC's Economic Sanctions Programs Imposed Against Countries and Individuals (Advisory 16-60)

On July 6, 2016, staff of DSIO issued an advisory in which it reminded all CFTC registrants of their obligations to comply with the economic sanctions programs outlined in the Office of Foreign Assets Control's (OFAC) regulations.[17] OFAC administers sanctions programs against countries and groups of individuals, such as identified terrorists and money launderers, that generally prohibit U.S. persons from engaging in transactions with individuals or entities located in countries that are subject to a sanction program administered by OFAC. The sanctions also may require U.S. persons to block (i.e., freeze) the property of: (1) any person that is on OFAC's list of Specially Designated Nationals and Blocked Persons (SDN list); and (2) any entity that is 50 percent or more owned, directly or indirectly, by such person. According to the CFTC, its registrants should regularly review the economic sanctions programs and SDN list each time these are updated and screen all new customers, and current customers periodically, to determine if the customer is located in one of the sanctioned countries or is on the SDN list.

ADDITIONAL CROSS-BORDER TOPICS

CFTC Issues Final Response to District Court Remand Order in SIFMA v. CFTC

On August 4, 2016, the CFTC issued a final response to the District Court's remand order (Final Response) in *Securities Industry and Financial Markets Association, et al. v. United States Commodity Futures Trading Commission* (SIFMA v. CFTC).[18] In SIFMA v. CFTC, the United States District Court for the District of Columbia, on September 16, 2014, denied SIFMA's demand that the CFTC be enjoined from enforcing extraterritorially Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the Dodd-Frank Act) and related regulations, and upheld the CFTC's 2013 Interpretive Guidance and Policy Statement Regarding Compliance With Certain Swap Regulations, which related to the cross-border application of its Title VII rules.[19] The court directed the CFTC to further explain and consider the costs and benefits of certain rules. In March 2015, the CFTC published an initial response to the District Court's remand order (Initial Response), which further explained the CFTC's earlier consideration of costs and benefits of these rules and solicited comment.[20] In issuing its Final Response, the CFTC stated that the Final Response further addressed cost-benefit issues raised and explained its approach to international harmonization of swaps regulations to carry out the Dodd-Frank Act reforms in cooperation with global regulators and to promote stable and healthy markets. However, the CFTC ultimately concluded that after "taking into account the facts and analysis in the original rulemaking preambles as well

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as the additional consideration of costs and benefits in the Initial Response and this release, the record does not establish a need to make changes in the substantive requirements of the remanded rules as originally promulgated at the present time in the context of the SIFMA remand order."

The CFTC recently issued a proposed rule and interpretations addressing the cross-border application of certain swap provisions of the CEA.[21] Specifically, the proposed rule defines key terms for purposes of applying the CEA's swap provisions to cross-border transactions and addresses the cross-border application of the registration thresholds and external business conduct standards for swap dealers (SDs) and major swap participants (MSPs), including the extent to which they would apply to swap transactions that are arranged, negotiated or executed using personnel located in the United States.

CFTC Issues Comparability Determination for Uncleared Swap Margin Requirements Under the Laws of Japan

On September 8, 2016, the CFTC (with a 2-1 vote) approved a comparability determination that would permit substituted compliance with certain of margin requirements for uncleared swaps adopted by the Japan Financial Services Agency (JFSA) as compared to the uncleared swap margin provisions of Title VII of the Dodd-Frank Act and CFTC regulations.[22]

In January of this year, the CFTC published its final rules that impose initial and variation margin requirements for Covered Swap Entities, or CSEs (defined above), in connection with uncleared swap transactions (the CFTC Margin Rules).[23] In May, the CFTC issued final rules establishing the jurisdictional reach of the CFTC Margin Rules (the Cross-Border Margin Rules).[24] The Cross-Border Margin Rules set out the circumstances under which a CSE is allowed to satisfy the requirements of the CFTC Margin Rules by complying with comparable foreign margin requirements (substituted compliance), offers certain CSEs a limited exclusion from the CFTC's margin requirements and outlines a framework for assessing whether a foreign jurisdiction's margin requirements are comparable to the CFTC's final uncleared swap margin rules (comparability determinations).

On June 17, 2016, JFSA submitted a request that the CFTC determine that laws and regulations applicable in Japan provide a sufficient basis for an affirmative finding of comparability with respect to the CFTC Margin Rules. As a result of the CFTC's comparability determination with respect to Japan's margin requirements for uncleared swaps, a CSE that is subject to both the CFTC Margin Rules and the JFSA's margin rules with respect to an uncleared swap that is also a noncleared over-the-counter (OTC) derivative may rely on substituted compliance for all aspects of the CFTC Margin Rules and the Cross-Border Margin Rules except that the CSE must comply with the inter-affiliate margin requirements of CFTC Regulation 23.159.

CFTC and Various Foreign Regulators Sign Counterparts to Memoranda of Understanding to Enhance Supervision of Cross-Border Regulated Entities

On July 28, 2016, the CFTC announced that CFTC Chairman Timothy Massad had signed counterparts with authorities in our Canadian provinces or territories to a 2014 Memorandum of Understanding (MOU) regarding cooperation and the exchange of information in the supervision and oversight of regulated entities that operate on a cross-border basis in the United States and Canada.[25] The scope of the MOU includes markets and organized trading platforms, central counterparties, trade repositories, and intermediaries, dealers, and other market participants.

Separately, on September 6, 2016, the CFTC announced that Chairman Massad had signed an MOU with the Comisión Nacional Bancaria y de Valores (CNBV) and the Banco de México (BDM) regarding cooperation and the exchange of information in the supervision and oversight of certain regulated entities that operate on a cross-border basis in the United States and Mexico.[26] Through the MOU, the CFTC, CNBV and BDM express their willingness to cooperate in the interest of fulfilling their regulatory mandates. The scope of the MOU includes central counterparties and trade repositories.

European Commission Deems U.S. DCMs to Be Equivalent

On July 1, 2016, the European Commission published its decision to grant equivalence to 15 designated contract markets (DCMs) located in the United States that operate under the regulatory oversight of the CFTC, in accordance with the Europeavtn Markets Infrastructure Regulation (EMIR).[27] In the absence of such equivalence determination, derivative contracts executed on the DCMs would have been deemed OTC derivatives under EMIR, subjecting such contracts to reporting and risk mitigation

obligations. In granting equivalence, the European Commission determined that the applicable legally binding requirements and supervisory and enforcement arrangements of the CFTC were equivalent to European Union requirements in respect of the regulatory objectives they achieve.

The European Commission Implementing Decision (EU) 2016/1073 became effective on July 22, 2016.

FINANCIAL OVERSIGHT STABILITY COUNCIL DEVELOPMENTS

Update: MetLife, Inc. v. Financial Stability Oversight Council

The litigation between the Financial Stability Oversight Council (FSOC) and MetLife, Inc. (MetLife) regarding FSOC's December 2014 designation of MetLife as a "systemically important financial institution" or "SIFI," pursuant to Section 113 of the Dodd-Frank Act is continuing through the appellate process.[28] In an opinion issued on March 30, 2016, the United States District Court for the District of Columbia ruled that FSOC's designation of MetLife as a SIFI was "arbitrary and capricious," and rescinded FSOC's final determination.[29] On April 20, 2016, FSOC filed an appeal with the U.S. Court of Appeals for the D.C. Circuit seeking the reversal of the District Court's ruling.[30] On June 16, 2016, FSOC filed its appellate brief setting forth a number of arguments that were summarized in our quarterly review for the second quarter of 2016.[31]

On August 15, 2015, MetLife filed its appellee brief arguing, among other things, that the District Court had correctly concluded that FSOC violated its own interpretive guidance by refusing to assess MetLife's vulnerability to material financial distress, and had improperly assumed distress at MetLife that was more severe than the definition of "material financial distress" in FSOC's final rule and interpretive guidance.[32] In a reply brief filed on September 9, 2016, FSOC argued that it could not have acted arbitrarily and capriciously because, in considering MetLife for designation as a SIFI, it examined criteria for SIFI designation taken directly from the statutory language of the Dodd-Frank Act, and that it was not required to examine the factors included in its interpretive guidance.[33]

Meanwhile, on August 22, 2016, the Chamber of Commerce of the United States (Chamber of Commerce) and the Investment Company Institute (ICI) jointly filed an *amici curiae* brief in support of MetLife, arguing that FSOC's decision to "assume material financial distress" in its consideration of MetLife for SIFI designation was inconsistent with the requirements of the Dodd-Frank Act.[34] The Chamber of Commerce and the ICI also argued that FSOC's decision was arbitrary and capricious because it ignored the historical realities of the insurance business as well as MetLife's "well-documented ability to weather crises."[35]

Oral arguments were scheduled for Monday, October 24, 2016.

NFA UPDATES

Proposed Reporting of Financial Ratios for CPOs and CTAs on NFA Forms PQR and PR

On September 6, 2016, the National Futures Association (NFA) filed with the CFTC a proposed amendment to NFA Rule 2-46, along with a proposed interpretive notice.[36] If approved, the proposed amendment would require CPO filers to report "any additional information in a form and manner prescribed by NFA," and the proposed interpretive notice would require registered CPOs and CTAs to report two financial ratios: (i) current assets over current liabilities as of the reporting quarter end, which would serve as a measure of the firm's liquidity, and (ii) total revenue earned over total expenses incurred during the prior 12 months, which would serve as a measure of the firm's operating margin. A CPO or CTA that is part of a holding company/subsidiary structure may elect to report the ratios at the parent level. CPOs and CTAs would be required to maintain records that support their ratio calculations, which would be subject to inspection by NFA during an examination or upon request.

Interpretive Notice Regarding NFA Form PQR — Minor Update and Other Reminders

On September 27, 2016, the NFA issued an interpretive notice with respect to Form PQR.[37] The notice announced minor updates to Form PQR (effective for filings covering the quarter ended September 30, 2016) which relate to the way CPOs enter information regarding disclosure of redemption halts or limitations on redemptions (as updated, the form permits the date of each participant disclosure to be listed in a separate box, instead of requiring all disclosure dates to be put in one box). In this notice, the NFA also reminded CPOs about the CFTC's

frequently asked questions regarding CFTC Form CPO-PQR which had been released in November 2015,[38] and about the new $200 fee that will be assessed on late Form PQR or Form PR filings going forward, beginning with reports for the quarter ended September 30, 2016.[39]

Updates to NFA Self-Examination Questionnaire

On August 15, 2016, the NFA updated the self-examination questionnaire for FCMs, forex dealer members (FDMs), IBs, CPOs and CTAs.[40] Specifically, the NFA added a section under "Supplemental Questionnaire for IBs on Forex Electronic Trading Systems — NFA Compliance Rules 2-39 and NFA Interpretive Notice 9060," and added technical clarifications under "Supplemental Questionnaire for CPOs on Financial — CFTC Regulation 4.22, 4.23 and 4.27, and NFA Compliance Rule 2-13."

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The authors would like to thank James L. Severs for his assistance in preparing this alert. James L. Severs is a 2016 graduate of Catholic University of America, Columbus School of Law, and is currently awaiting his bar exam results.

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[1] CFTC Press Release 7457-16, *CFTC Expands Interest Rate Swap Clearing Requirement* (Sept. 28, 2016), http://www.cftc.gov/PressRoom/PressReleases/pr7457-16; *Q & A – Clearing Requirement Determination Under Section 2(h) of the CEA for Interest Rate Swaps* (Sept. 28, 2016), http://www.cftc.gov/idc/groups/public/@newsroom/documents/file/irsclearing_qa092816.pdf; *Clearing Requirement Determination Under Section 2(h) of the Commodity Exchange Act for Interest Rate Swaps*, 81 Fed. Reg. 71202 (Oct. 14, 2016)(Adopting Release), http://www.cftc.gov/idc/groups/public/@lrfederalregister/documents/file/2016-23983a.pdf. *See also Clearing Requirement Determination Under Section 2(h) of the CEA for Interest Rate Swaps*, 81 Fed. Reg. 39,506 (June 16, 2016)(Proposing Release), http://www.cftc.gov/idc/groups/public/@lrfederalregister/documents/file/2016-14035a.pdf.

[2] Proposed Rule 3.10(c)(6) defines "international financial institution" to mean each of the following and any other international financial institution that the CFTC may designate: Int'l Monetary Fund, Int'l Bank for Reconstruction and Development, European Bank for Reconstruction and Development, Int'l Development Association, Int'l Finance Corp., Multilateral Investment Guarantee Agency, African Development Bank, African Development Fund, Asian Development Bank, Inter-American Development Bank, Bank for Economic Cooperation and Development in the Middle East and North Africa, InterAmerican Investment Corp., Council of Europe Development Bank, Nordic Investment Bank, Caribbean Development Bank, European Investment Bank and European Investment Fund.

[3] CFTC Press Release 7412-16, *CFTC Proposes to Amend the Conditions for Exemption From Registration for Certain Foreign Persons* (July 27, 2016), http://www.cftc.gov/PressRoom/PressReleases/pr7412-16; *Exemption From Registration for Certain Foreign Persons*, 81 Fed. Reg. 51824 (Aug. 5, 2016)(Proposing Release), http://www.cftc.gov/idc/groups/public/@lrfederalregister/documents/file/2016-18210a.pdf.

[4] See CFTC Letters 15-37 (June 4, 2015) and 16-08 (Feb. 12, 2016) (no-action relief permitting Foreign Intermediaries to rely on the exemption from registration under CFTC Regulation 3.10(c)(3)(i) if their activities involve swaps that are not subject to a CFTC clearing requirement).

[5] *Commodity Pool Operator Annual Report*, 81 Fed. Reg. 51828 (Aug. 5, 2016)(Proposing Release), http://www.cftc.gov/idc/groups/public/@lrfederalregister/documents/file/2016-18400a.pdf.

[6] A CPO seeking to use IFRS must file a notice with the NFA representing that:

> (1) the pool is organized under the laws of a foreign jurisdiction;
>
> (2) the Annual Report will include a schedule of investments (condensed unless a full schedule is required under IFRS);
>
> (3) the use of IFRS to prepare the Annual Report is not inconsistent with representations set forth in the pool's disclosures to participants;
>
> (4) any special allocations of ownership equity will be reported in accordance with CFTC Regulation 4.22(e); and
>
> (5) in the event that IFRS requires consolidated financial statements for the pool (e.g., in a master-feeder fund structure), all applicable disclosures required by U.S. generally accepted accounting principles will be provided.

[7] *Commodity Pool Operator Annual Report*, 81 Fed. Reg. 61147 (Sept. 6, 2016)(Extension of Comment Period), http://www.cftc.gov/idc/groups/public/@lrfederalregister/documents/file/2016-21153a.pdf.

[8] CFTC Press Release 7422-16, *CFTC Proposes to Amend the Timing for Filing Chief Compliance Officer Annual Reports by Certain Registrants* (Aug. 9, 2016), http://www.cftc.gov/PressRoom/PressReleases/pr7422-16; *Chief Compliance Officer Annual Report Requirements for Futures Commission Merchants, Swap Dealers, and Major Swap Participants; Amendments to Filing Dates*, 81 Fed. Reg. 53343 (Aug. 12, 2016)(Proposing Release), http://www.cftc.gov/idc/groups/public/@lrfederalregister/documents/file/2016-19231a.pdf.

[9] *No-Action Relief for Futures Commission Merchants, Swap Dealers, and Major Swap Participants From Compliance With the Timing Requirements of Commission Regulation 3.3(f)(2) Relating to Annual Reports by Chief Compliance Officers*, CFTC Staff Letter No. 15-15 (March 27, 2015), http://www.cftc.gov/idc/groups/public/@lrlettergeneral/documents/letter/15-15.pdf.

[10] CFTC Press Release 7421-16, *CFTC Announces Enhancements to Protect Customer Funds* (Aug. 8, 2016), http://www.cftc.gov/PressRoom/PressReleases/pr7421-16; *No-Action Relief With Respect to CFTC Regulation 1.25 Regarding Money Market Funds*, CFTC Letter No. 16-68 (Aug. 8, 2016) (DSIO Letter), http://www.cftc.gov/idc/groups/public/@lrlettergeneral/documents/letter/16-68.pdf; *Staff Interpretation Regarding CFTC Part 39 in Light of Revised SEC Rule 2a-7*, CFTC Letter No. 16-69 (Aug. 8, 2016) (DCR Letter), http://www.cftc.gov/idc/groups/public/@lrlettergeneral/documents/letter/16-69.pdf.

[11] This no-action position does not provide relief from the issuer-based concentration limits conditions of Regulation 1.25 for Rule 2a-7 government funds that do not invest exclusively in U.S. government securities. An FCM must limit its investment in a single such Rule 2a-7 government fund to no more than 10 percent of the FCM's total assets held in segregation, and must limit its investment in a single family of money market funds that offer such a government fund to no more than 25% of the FCM's total assets held in segregation. CFTC Letter No. 16-68, *supra* note 10.

[12] *Practical Application of No-Action Letter No. 16-68 Regarding Investments in Money Market Mutual Funds*, CFTC Staff Advisory No. 16-75 (Oct. 18, 2016), http://www.cftc.gov/idc/groups/public/@lrlettergeneral/documents/letter/16-75.pdf.

[13] The Prudential Regulators are the Federal Reserve System, the Office of the Comptroller of the Currency, the Federal Deposit Insurance Corporation, the Farm Credit Administration and the Federal Housing Finance Agency.

[14] Peter M. Hong and Nicole Simon, Quarterly Review: CFTC & NFA Developments for CPOs, CTAs and Other Asset Managers—Adoption of Final Rule Regarding Margin for Uncleared Swaps (April 2016), http://www.stradley.com/insights/publications/2016/04/ctfc-alert-april-2016.

[15] *Request to Include Security-Based Swaps in Product Set for Initial Margin for Uncleared Swaps*, CFTC Letter No. 16-71 (Aug. 23, 2016), http://www.cftc.gov/idc/groups/public/@lrlettergeneral/documents/letter/16-71.pdf.

[16] *Chief Compliance Officer Reporting Line*, CFTC Staff Advisory No. 16-62, (July 25, 2016), http://www.cftc.gov/idc/groups/public/@lrlettergeneral/documents/letter/16-62.pdf.

[17] *Compliance With Suspicious Activity Reporting Requirements and Office of Foreign Assets Control Economic Sanctions Programs*, CFTC Staff Advisory No. 16-60 (July 6, 2016), http://www.cftc.gov/idc/groups/public/@lrlettergeneral/documents/letter/16-60.pdf.

[18] CFTC Press Release 7418-16, *CFTC Announces Two Cross-Border Related Actions* (Aug. 4, 2016), http://www.cftc.gov/PressRoom/PressReleases/pr7418-16; *Final Response to District Court Remand Order in Securities Industry and Financial Markets Association, et al. v. United States Commodity Futures Trading Commission*, 81 Fed. Reg. 54478 (Aug. 16, 2016), https://www.gpo.gov/fdsys/pkg/FR-2016-08-16/pdf/2016-18854.pdf.

[19] *Interpretive Guidance and Policy Statement Regarding Compliance With Certain Swap Regulations*, 78 Fed. Reg. 45292 (July 26, 2013), https://www.gpo.gov/fdsys/pkg/FR-2013-07-26/pdf/2013-17958.pdf.

[20] *Initial Response to District Court Remand Order in Securities Industry and Financial Markets Association, et al. v. United States Commodity Futures Trading Commission*, 80 Fed. Reg. 12555 (March 10, 2015), http://www.cftc.gov/idc/groups/public/@lrfederalregister/documents/file/2015-05413a.pdf.

[21] *Cross-Border Application of the Registration Thresholds and External Business Conduct Standards Applicable to Swap Dealers and Major Swap Participants*, 81 Fed. Reg. 71946 (Oct. 11, 2016), http://www.cftc.gov/idc/groups/public/@lrfederalregister/documents/file/2016-24905a.pdf.

[22] CFTC Press Release 7442-16, *CFTC Approves Final Rules for System Safeguards Testing Requirements and a Comparability Determination for Japan Uncleared Swap Margin Rules for Substituted Compliance Purposes* (Sept. 8, 2016), http://www.cftc.gov/PressRoom/PressReleases/pr7442-16; *Comparability Determination for Japan: Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants*, 81 Fed. Reg. 63377 (Sept. 15, 2016), http://www.cftc.gov/idc/groups/public/@lrfederalregister/documents/file/2016-22045a.pdf.

[23] For more information about the CFTC Margin Rules, see "Adoption of Final Rule Regarding Margin for Uncleared Swaps" in our Quarterly Review for the first quarter of 2016, *supra* note 14.

[24] For more information about the Cross-Border Margin Rules, see Peter M. Hong and Nicole Simon, Quarterly Review: CFTC & NFA Developments for CPOs, CTAs and Other Asset Managers—Adoption of Cross-Border Application of Margin Requirements for Uncleared Swaps (July 2016), http://www.stradley.com/insights/publications/2016/07/cftc-alert-july-2016.

[25] CFTC Press Release 7413-16, *CFTC and Four Canadian Authorities Sign Counterparts to Memorandum of Understanding to Enhance Supervision of Cross-Border Regulated Entities* (July 28, 2016), http://www.cftc.gov/PressRoom/PressReleases/pr7413-16; *Counterpart to Memorandum of Understanding Between the United States Commodity Futures Trading Commission and Superintendent of Securities (Yukon)* (July 27, 2016), http://www.cftc.gov/idc/groups/public/@internationalaffairs/documents/file/cftc-ssy-supervisorymou072716.pdf; Counterpart to Memorandum of Understanding Between the United *States Commodity Futures Trading Commission and Superintendent of Securities (Northwest Territories)* (July 27, 2016), http://www.cftc.gov/idc/groups/public/@internationalaffairs/documents/file/cftc-ssnt-supervisorymou072716.pdf; *Counterpart to Memorandum of Understanding Between the United States Commodity Futures Trading Commission and Superintendent of Securities (Nunavut)* (July 27, 2016), http://www.cftc.gov/idc/groups/public/@internationalaffairs/documents/file/cftc-ssnu-supervisorymou072716.pdf; *Counterpart to Memorandum of Understanding Between the United States Commodity Futures Trading Commission and Superintendent of Securities (Prince Edward Island)* (July 27, 2016), http://www.cftc.

gov/idc/groups/public/@internationalaffairs/documents/file/cftc-ssp-supervisorymou072716.pdf.

[26] CFTC Press Release 7440-16, *CFTC Signs MOU With Two Mexican Authorities to Enhance Supervision of Cross-Border Regulated Entities* (Sept. 6, 2016), http://www.cftc.gov/PressRoom/PressReleases/pr7440-16; *Memorandum of Understanding Between the United States Commodity Futures Trading Commission, the Comisión Nacional Bancaria y de Valores (CNBV) and the Banco de México (BDM)* (Aug. 31, 2016), http://www.cftc.gov/idc/groups/public/@internationalaffairs/documents/file/cftc-cnbv-bdm-supervisorymou08.pdf.

[27] Commission Implementing Decision (EU) 2016/1073 of 1 July 2016 on the Equivalence of Designated Contract Markets in the United States of America in Accordance With Regulation (EU) No 648/2012 of the European Parliament and of the Council (July 1, 2016), http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32016D1073&from=EN.

[28] For additional background regarding the MetLife case, see our Quarterly Review for the first and second quarters of 2016, *supra* notes 14 and 24, respectively.

[29] *MetLife, Inc. v. Financial Stability Oversight Council*, No. 15–0045, 2016 WL 1391569 (D.D.C. March 30, 2016).

[30] *MetLife, Inc. v. Financial Stability Oversight Council*, No. 16-5086 (June 16, 2016).

[31] See our Quarterly Review for the second quarter of 2016, *supra* note 24.

[32] Brief for Appellee, *MetLife, Inc. v. Financial Stability Oversight Council*, No. 16-5086 (Aug. 15, 2016).

[33] Reply Brief for Appellant, *MetLife, Inc. v. Financial Stability Oversight Council*, No. 16-5086 (Sept. 9, 2016).

[34] Brief for Chamber of Commerce of the United States and Investment Company Institute as Amici Curiae Supporting Appellee, *MetLife, Inc. v. Financial Stability Oversight Council*, 16-5086 (Aug. 22, 2016). In addition to the briefs discussed in this Quarterly Review, a number of amici curiae briefs have been filed by other parties.

[35] *Id.*

[36] National Futures Association Rule Submission Re: Collection of CPO/CTA Financial Information – NFA Compliance Rule 2-46 and NFA Interpretive Notice NFA Compliance Rule 2-46: Reporting Financial Information on NFA Forms PQR and PR (Sept. 6, 2016), http://www.nfa.futures.org/news/PDF/CFTC/CR-2-46_InterpNotc9071_082016.pdf.

[37] *Minor change to the CPO Form PQR and an important compliance reminder to CPOs and CTAs about late fees for NFA Forms PQR and PR*, NFA Notice to Members I-16-20 (Sept. 27, 2016), https://www.nfa.futures.org/news/newsNotice.asp?ArticleID=4745.

[38] *CFTC Division of Swap Dealer and Intermediary Oversight Responds to Frequently Asked Questions Regarding Commission Form CPO-PQR* (Nov. 5, 2015), http://www.cftc.gov/idc/groups/public/@newsroom/documents/file/faq_cpocta110515.pdf.

[39] For more information on late fees, see *Effective date of amendment to Compliance Rule 2-46: Late fee for NFA Forms PQR and PR filings*, NFA Notice to Members I-16-2016 (June 21, 2016), http://www.nfa.futures.org/news/newsNotice.asp?ArticleID=4730.

[40] *NFA updates Self-Examination Questionnaire for FCMs, FDMs, IBs, CPOs and CTAs, NFA Member Newsletter* (Aug. 15, 2016), http://www.nfa.futures.org/news/member-newsletter-2016/081516.HTML.