CFTC Staff Clarifies Registration Relief Available to Non-US Asset Managers

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No-action relief confirms that non-US asset managers may rely on an exemption from CFTC registration when trading uncleared swaps in the United States for the accounts of their non-US clients, an issue that had been in doubt following Dodd-Frank’s enactment.

On February 12, the CFTC’s Division of Swap Dealer and Intermediary Oversight issued a no-action letter that clarifies the scope of an exemption from registration on which a non-US firm (Foreign Firm) can rely when seeking to trade in CFTC-regulated markets for commodity interests (such as futures, options on futures, and swaps) on behalf of non-US clients (Foreign Clients).[1]

The Foreign Business Exemption allows a Foreign Firm to avoid registration as a commodity pool operator (CPO), a commodity trading advisor (CTA), or an introducing broker (IB), provided that the commodity interest transactions for its non-US clients (Foreign Clients) are submitted for clearing through a registered futures commission merchant (FCM). Because the CFTC also regulates swaps that are not required to be cleared, it was uncertain whether a Foreign Firm could rely on the Exemption if uncleared swaps were traded for Foreign Clients’ accounts. This uncertainty also extended to US-based managers (Domestic Firms) that sought to provide commodity trading advice with respect to Foreign Clients of Foreign Firms and, in doing so, sought to confirm whether the Foreign Firms had a proper basis for exemption from CFTC registration.

The CFTC staff’s letter clarifies that Foreign Firms may rely on the Foreign Business Exemption even if the commodity interests being traded include uncleared swaps. The underpinning for this relief is the staff’s position that the Foreign Business Exemption “was not intended to impose an independent clearing requirement on commodity interest transactions” that are not separately “require[d] to be cleared.” The letter therefore realigns the Foreign Business Exemption with the current clearing framework for commodity interest transactions.

Background on the Foreign Business Exemption

Today, the Foreign Business Exemption provides relief from registration as a CPO, a CTA, or an IB to any Foreign Firm that conducts business solely on behalf of Foreign Clients, subject to the requirement that any commodity interest transaction must be submitted for clearing through a registered FCM (Clearing Condition).

The Foreign Business Exemption did not refer to CTAs, CPOs, or IBs when it was proposed in 2007.[2] Instead, the CFTC drafted the Exemption to provide relief to “foreign brokers” from FCM registration. In that context, the CFTC explained, the Clearing Condition would prevent a scenario in which a foreign broker could clear trades as “a remote clearing member of a derivatives clearing organization” but “without having to register as an FCM.”[3] The Clearing Condition was therefore envisioned as a tool to ensure the CFTC’s close, continued regulation of clearing activity.

CPOs, CTAs, and IBs were added to the Foreign Business Exemption when it was finalized later in 2007, based on comments from the public that sought clarity for other market participants that acted on behalf of Foreign Clients. The CFTC explained that this expansion of the Exemption was consistent with a longstanding policy of focusing its resources on “domestic” participants in the futures markets, leaving the protection of Foreign Clients to their
home country regulators.\[4\]

When it was finalized in 2007, the Foreign Business Exemption only applied to futures and options on futures. Those commodity interests were required to be cleared under the Commodity Exchange Act and CFTC regulations. Thus, the Clearing Condition would not have imposed any additional clearing burden on Foreign Firms at that time.

This situation changed with the enactment of Dodd-Frank in 2010 and certain amendments to the CFTC’s regulations in the following years. In particular, Dodd-Frank amended the Commodity Exchange Act to include swaps and, as relevant here, to require the CFTC to determine whether certain classes of swaps should be required to be cleared.\[^5\] In December 2012, the CFTC published a formal clearing determination with respect to certain index credit default swaps and interest rate swaps.\[^6\]

The CFTC also amended the Foreign Business Exemption, in August 2012, to refer to commodity interest transactions entered into on a bilateral basis or on or subject to the rules of a swap execution facility (SEF).\[^7\] In doing so, the CFTC explained that the change was intended to ensure the uniform treatment of commodity interests under the Exemption regardless of whether they were traded on contract markets (such as futures and options on futures and, possibly now, swaps), bilaterally (such as swaps, as had historically been the case), or on SEFs (swaps again).\[^8\]

**No-Action Relief Focuses the Clearing Condition on Swaps Subject to Mandatory Clearing**

Because the Foreign Business Exemption continues to include the Clearing Requirement, it has been unclear whether—as a condition of its relief—Foreign Firms would have to submit for clearing swaps that the CFTC had not separately mandated were required to be cleared. This potential outcome appeared to leave the Foreign Business Exemption far from the CFTC’s goal of ensuring uniform treatment. Rather, it seemed that uniform treatment under the Exemption could only be achieved by treating commodity interests differently, based on whether they were separately required to be cleared.

The no-action letter clarifies that the Clearing Condition does not impose an independent clearing requirement. As a result, a Foreign Firm will be able to rely on the Foreign Business Exemption if swap transactions for its Foreign Clients are executed bilaterally or on SEFs on a noncleared basis. This is true even if a swap transaction is able to be cleared on a voluntary basis, as the no-action relief applies “with respect to swaps not subject to a [CFTC] clearing requirement.” The relief should be particularly helpful given the current uncertainty about when additional classes of swaps will be required to be cleared.

The staff’s relief will expire once the CFTC adopts an amendment to the Foreign Business Exemption that provides for the Clearing Condition to apply only to those commodity interests subject to a separate clearing requirement.\[^9\] Plainly, a permanent fix to the Exemption will be preferable in the long run. Although the staff gave no indication of whether or even when such a rulemaking will be proposed, the suggestion of such an amendment is nonetheless encouraging.

**The No-Action Relief’s Practical Significance**

The no-action letter will directly help Foreign Firms that seek to transact for Foreign Clients in commodity interests with US counterparties or on CFTC-regulated markets.\[^10\] That is, the no-action letter removes the disconnect between the Clearing Condition and the fact that certain swaps are not separately required to be cleared.

Domestic Firms may also benefit indirectly from the no-action letter in connection with entering into advisory relationships with respect to Foreign Clients of Foreign Firms:

- If a Domestic Firm is registered with the CFTC, it generally must also be a member of the National Futures Association (NFA). As such, the Domestic Firm will be subject to NFA Bylaw 1101, a provision that prohibits NFA member firms from doing business with nonmembers that are required to be registered with the CFTC. Accordingly, a Domestic Firm that seeks to provide commodity trading advice to a Foreign Client must generally establish whether the Foreign Firm can rely on an exemption from CFTC registration.\[^11\] By looking to the no-action letter, a Domestic Firm may now be able to make the determination required under Bylaw 1101 with respect to a Foreign Firm, based on the Foreign Business Exemption.
The no-action letter may also help a Domestic Firm that is exempt from CFTC registration and thus not subject to Bylaw 1101. If such a Domestic Firm seeks to trade commodity interests for a Foreign Client, it may receive an inquiry from the FCM executing the trades or the trade counterparty about the CFTC exempt status of the Foreign Firm (i.e., pursuant to Bylaw 1101 obligations applicable to the FCM or the counterparty). In light of the no-action letter, the Domestic Firm may now be able to confirm that the Foreign Firm is able to rely on the Foreign Business Exemption.

Conclusion

Financial markets and advisory services are global, with products traded across international borders all the time. It is only natural that legal requirements designed for domestic market participants can sometimes cause friction for foreign entrants. This has certainly been the case under the Foreign Business Exemption, even though it was designed to exclude from CFTC registration Foreign Firms that sought to trade commodity interests in CFTC-regulated markets for their Foreign Clients. The no-action letter therefore reflects something of a course correction, by recentering the Clearing Requirement on those commodity interests that are separately required to be cleared. Firms should now have greater legal certainty when they enter into advisory relationships with respect to Foreign Clients that will involve trading swaps.


[3] Id. at 15639.


[9] In technical terms, the letter will expire on the later of the date that such an amendment takes effect or that firms are required to comply with the amended rule.


[11] From a Foreign Firm’s perspective, it may not be obvious why it would need such an exemption when dealing with a Domestic Firm on behalf of a Foreign Client. Moreover, certain exemptions commonly used by asset managers impose conditions with which Foreign Firms have limited experience or no need to assess on their own accord. See, e.g., 17 C.F.R. § 4.13(a)(3) (providing an exemption from CPO registration for a sponsor of a commodity pool that limits its commodity interest exposure to a certain percentage of its liquidation value.)

[12] The Domestic Firm will still need to be registered or avail itself of an exemption with respect to the commodity trading advice that it provides for the Foreign Client. The Domestic Firm cannot rely on the Foreign Business Exemption with respect to its own status.