**U.S. COMMODITY FUTURES TRADING COMMISSION**
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Division of Swap Dealer and Intermediary Oversight
Division of Clearing and Risk

**To:** **Derivatives Clearing Organizations, Futures Commission Merchants, Joint Audit Committee Members, and Market Participants**

**Subject:** **Supplemental Advisory and Time-Limited No-Action Relief with Respect to the Treatment of Separate Accounts by Futures Commission Merchants**

## I. Background

Protection of customer assets is a core responsibility of the Commodity Futures Trading Commission ("CFTC"), under both the Commodity Exchange Act and the Commission's regulations. As noted in sections 2.4 and 4.2 of the Commission's 2020-2024 Strategic Plan, the Commission works vigilantly to protect customer assets, and enforces its requirements in partnership with self-regulatory organizations. The Commission regulations discussed in this Letter, Regulations 1.56 and 39.13(g)(8)(iii), are key tools to achieve these goals.

On July 10th, 2019, the Division of Clearing and Risk (DCR) and the Division of Swap Dealer and Intermediary Oversight (DSIO) (together, the Divisions) issued CFTC Letter 19-17, "Advisory and Time-Limited No-Action Relief with Respect to the Treatment of Separate Accounts by Futures Commission Merchants" (Letter 19-17). Letter 19-17 provided "guidance regarding CFTC Regulation 1.56(b)[1] and time-limited no-action relief regarding Regulation 39.13(g)(8)(iii)[2] as these rules relate to the treatment of separate accounts of the same customer, a beneficial owner." The Letter set forth certain dates by which conditions on the relief needed to be accomplished. Letter 19-17 also stated that the no-action relief regarding Regulation 39.13(g)(8)(iii) "will extend until June 30, 2021, in order to provide Staff with time to recommend, and the Commission with time to determine whether to conduct, and if so, to in fact conduct, a rulemaking to implement appropriate relief on a permanent basis."

[1] 17 C.F.R. 1.56(b)

[2] 17 C.F.R. 39.13(g)(8)(iii)

On September 13, 2019, the Directors of DCR and DSIO issued a "Statement by the Directors of the Division of Clearing and Risk and the Division of Swap Dealer and Intermediary Oversight Concerning the Treatment of Separate Accounts of the Same Beneficial Owner" ("Statement"). The Statement indicated an expectation that "DCOs and FCMs and their customers will find solutions that satisfy the Commission's requirements, as clarified in the Letter, by September 15, 2020."

On September 10, 2020, the Futures Industry Association ("FIA") requested further relief on behalf of its member firms that are registered with the CFTC as futures commission merchants, in light in particular of the challenges posed by the COVID-19 Pandemic, as well as other issues that had arisen since September of 2019.[3] The relief provided herein is based on the Divisions' consideration of that request and on subsequent discussions with a number of interested parties.

**II. Staff Action**

A. Time-limited no-action relief.

In light of the COVID-19 Pandemic, and the consequent difficulties FCMs may have encountered with (a) identifying customer agreements that may contain provisions that are inconsistent with the terms of Regulation 1.56 (as interpreted in Letter 19-17, as clarified by the Statement) and working with customers to amend such agreements, and (b) complying with the conditions to the no-action relief in Letter 19-17, the Divisions have determined that it is appropriate to provide the following time-limited no-action relief: Until March 31, 2021, neither DCR nor DSIO will recommend that the Commission take enforcement action against an FCM on the ground that either (a) such FCM has not yet complied with the conditions to the relief with respect to Regulation 39.13(g)(8)(iii) or (b) despite Regulation 1.56, such FCM has agreements that limit recourse to the account owner, including between separate accounts of the same customer. We urge self-regulatory organizations to take similar action with respect to the application to separate accounts of their rules pursuant to Regulation 39.13(g)(8)(iii)[4] or any account under rules analogous to Regulation 1.56.

The Divisions note that this further relief is due only to the extraordinary difficulties created by the COVID-19 Pandemic. After March 31, 2021, any cases where either of the Divisions learns

[3] *See* Letter dated September 10, 2020 from Walt L. Lukken to Josh Sterling and Clark Hutchison III

[4] Given that Reg. 39.13(g)(8)(iii) applies, in terms, directly to derivatives clearing organizations, the Divisions would not recommend that the Commission take enforcement action against a derivatives clearing organization that provides such relief to an FCM that does not comply with the conditions to relief set forth in Letter 19-17, through the extended deadline of March 31, 2021.

or finds that an FCM is not in compliance with Regulation 1.56 will be referred to the Division of Enforcement.

B. Interpretation regarding 1.56.

There is no specific or express language that must be contained in customer agreements in order for an FCM to meet the requirements of Regulation 1.56. As Letter 19-17 made clear, Regulation 1.56(b) prohibits an FCM from agreeing to (1) guarantee the beneficial owner against loss, (2) limit the loss of the beneficial owner, or (3) prohibit the FCM from calling for or attempting to collect initial and maintenance margin as established by the rules of the applicable board of trade. Separately, Regulation 1.56(c) provides that no person may represent that an FCM will engage in any of the acts or practices described in 1.56(b). An FCM agreement that does not contain (or incorporate by reference) language that can be construed as a representation that the FCM agrees to any of those three points would meet the requirements of Regulation 1.56; an FCM need not have additional provisions regarding its rights against the beneficial owner under such an agreement.

An FCM and its client (and the client's asset manager) can, consistent with Regulation 1.56, agree to a protocol to address rare occasions where margin calls in one account of the beneficial owner at the FCM are not timely met. Pursuant to such a protocol, on such an occasion, the FCM would promptly follow a specific series of defined steps before resorting to liquidation or accessing the funds in the other accounts of the beneficial owner held at the FCM. Nonetheless, the FCM must retain, at all times, the discretion to determine that the facts and circumstances of a particular shortfall are extraordinary and therefore necessitate accelerating the timeline and relying on the FCM's protocol for liquidation or for accessing funds in the other accounts of the beneficial owner held at the FCM.

In some cases, the liability of a beneficial owner may be limited due solely to external law applicable to that beneficial owner that operates independent of contractual agreements. This would include state laws establishing separate accounts of insurance companies and cases of sovereign immunity, or similar cases. For the avoidance of doubt, an agreement between an FCM and a beneficial owner that recognizes, but does not add to, a statutory limitation of liability applicable to the beneficial owner would not violate Regulation 1.56.

**C.** Cases where compliance with Regulation 1.56 is ambiguous

**Mitigating Legal Risk:** To the extent that a statement in an FCM customer agreement entered into before March 31, 2021[5] can be construed as a representation to limit recourse in any of the

[5] For purposes of this Letter, adding an account to an agreement for a particular beneficial owner who was previously a party to that existing agreement would not be construed as a new agreement, while adding a new beneficial owner (who was not previously a party to that agreement) would be considered a new agreement.

three ways referred to in Reg. 1.56(b), but the FCM reasonably believes that other provisions (*e.g.*, applicable law and severability) of the agreement negate any such representations or otherwise bring the agreement within the requirements of Regulation 1.56, the FCM should seek to effectively mitigate legal risk regarding the compliance of the agreement with Regulation 1.56. In these circumstances, compliance with Regulation 1.56 is ambiguous, and the FCM should obtain (a) legal Opinion(s) or well-reasoned memorandum(a) from outside counsel confirming that its customer agreements do not (1) guarantee the beneficial owner against loss, (2) limit the loss of the beneficial owner, or (3) prohibit the FCM from calling for or attempting to collect initial and maintenance margin as established by the rules of the applicable board of trade, by March 31, 2021.

**Disclosure to address prior representation:** Separately and in addition, to the extent that the language used in an agreement can be construed to have been a representation in violation of Regulation 1.56, the Divisions would view any such violation with respect to an agreement entered into before March 31, 2021 as cured where an FCM promptly, but in any event no later than March 31, 2021, sends a written disclosure to the beneficial owner that (a) Regulation 1.56 provides that the FCM may not represent that it will (1) guarantee the beneficial owner against loss, (2) limit the loss of the beneficial owner, or (3) prohibit the FCM from calling for or attempting to collect initial and maintenance margin as established by the rules of the applicable board of trade, and (b) explains any reliance upon the operation of applicable law and severability contractual provisions with regard to compliance with Regulation 1.56, such disclosure will be considered as an effective cure). In such a case, the Divisions would not recommend enforcement action for such prior representation. For the avoidance of doubt, this disclosure is not a substitute for mitigating legal risk regarding the agreements as described above.

D. Extension of conditional no-action relief with respect to Regulation 39.13(g)(8)(iii).

Letter 19-17 stated that the no-action relief with respect to Regulation 39.13(g)(8)(iii) "will extend until June 30, 2021, in order to provide Staff with time to recommend, and the Commission with time to determine whether to conduct, and if so, to in fact conduct, a rulemaking to implement appropriate relief on a permanent basis." It was considered that this time-frame would also allow Staff and the Commission to benefit from the experience of DCOs, FCMs, and customers in operating under the conditions to that no-action relief. In light of the extended time-frame for the implementation of those conditions, the Divisions are extending the no-action relief with respect to Regulation 39.13(g)(8)(iii) until December 31, 2021. If the process described above – *i.e.*, for Staff to recommend, and the Commission to determine, whether to conduct, and if so, to in fact conduct, a rulemaking to implement appropriate relief on a permanent basis – is not completed by that date, the Divisions will consider further extension of this timeframe.

This letter, and the position taken herein, represent the views of DSIO and DCR only, and do not necessarily represent the position or view of the Commission or of any other office or division of the Commission. The no-action relief set forth in Letter 19-17, as modified by this letter, does not excuse persons relying thereon from compliance with any other applicable requirements contained in the CEA or in Commission Regulations.

Questions regarding this advisory and no-action relief can be directed towards Robert B. Wasserman, Chief Counsel, Division of Clearing and Risk, rwasserman@cftc.gov, or (202) 418-5092.

**/s/_____**
**M. Clark Hutchison**
**Director**

**/s/_____**
**Joshua B. Sterling**
**Director**