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Request for Relief – CEA § 4k, 7 U.S.C. § 6k, and Commission Regulation 3.10(c)(3)(i), 17 C.F.R. § 3.10(c)(3)(i)

February 2, 2016

Via Email

Ms. Eileen Flaherty
Director
Division of Swap Dealer and Intermediary Oversight
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, N.W.
Washington, D.C. 20581

Re: Request for Relief – Commodity Exchange Act Section 4k and Commission Regulation 3.10(c)(3)(i)

Dear Ms. Flaherty:

The Asset Management Group [1] of the Securities Industry and Financial Markets Association ("SIFMA AMG" or "AMG") and the Investment Adviser Association [2] ("IAA") (SIFMA AMG and IAA, collectively as the "Associations") are writing to request no-action relief from the registration requirements of the Commodity Exchange Act ("CEA") [3] for commodity pool operators ("CPO") and commodity trading advisors ("CTA") located outside of the United States (collectively, "Foreign Intermediaries") who would otherwise be exempt from registration under Commodity Futures Trading Commission (the "Commission") Regulation 3.10(c)(3)(i) [4] but for the condition that commodity interest [5] transactions be submitted for

[1] SIFMA AMG's members represent U.S. asset management firms whose combined global assets under management exceed $34 trillion. The clients of SIFMA AMG member firms include, among others, tens of millions of individual investors, registered investment companies, endowments, public and private pension funds, UCITS and private funds such as hedge funds and private equity funds.

[2] IAA is a not-for-profit association that represents the interests of investment adviser firms registered with the U.S. Securities and Exchange Commission ("SEC"). The IAA's membership consists of about 600 firms that collectively manage $16 trillion for a wide variety of individual and institutional investors, including pension plans, trusts, investment companies, private funds, endowments, foundations, and corporations. For more information, please visit www.investmentadviser.org.

[3] 7 U.S.C. § 1 *et al.*

[4] 17 C.F.R. § 3.10(c)(3)(i) (text in Appendix II).

clearing through a futures commission merchant ("FCM") registered with the Commission. Because not all commodity interest transactions are required to be cleared under the CEA and Commission Regulations promulgated thereunder ("Commission Regulations"), [6] including swaps not subject to a mandatory clearing determination under Section 2(h) of the CEA and Part 50 of the Commission Regulations, Regulation 3.10(c)(3)(i) could be read to require as a condition for the exemption the clearing of swaps beyond the Commission's mandatory clearing requirement. The Associations submit that this broader condition was not intended when the Commission made conforming changes to Regulation 3.10(c)(3)(i) to address its authority over swaps and, as a result, believe that the clearing condition in Regulation 3.10(c)(3)(i) should be limited to the Commission's clearing requirement.[7]

This issue has broad impact upon the Associations' members, either because members manage money for or have within their corporate structure a Foreign Intermediary who enters into swap transactions not subject to a Commission clearing requirement with U.S. person counterparties on behalf of persons located outside the United States, its territories or possessions ("Non-U.S. Persons").

For these reasons, explained further below, the Associations request that the Division of Swap Dealer and Intermediary Oversight (the "Division") not recommend an enforcement action against a person located outside the United States, its territories or possessions engaged in the activity of an introducing broker ("IB"), as defined in Commission Regulation 1.3(mm); a CTA, as defined in Commission Regulation 1.3(bb); or a CPO, as defined in Commission Regulation 1.3(nn), in connection with swaps not subject to a Commission clearing requirement[8] only on behalf of persons located outside the United States, its territories or possessions, for failure to register in such capacity.

In addition to requesting this relief, the Associations intend to petition the Commission for a permanent correction of the Regulation.

I. Amendment History of Commission Regulation 3.10(c)(3)(i)

Regulation 3.10(c)(3)(i) was amended in 2007 to provide an exemption from registration as a CPO or a CTA, as well as from IB registration, under the following circumstances:

- The firm is located outside the United States;

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[5] The term, "commodity interest," means any futures contract, swap, or other transaction subject to Commission regulation under the CEA. 17 C.F.R. § 1.3(yy).

[6] 17 C.F.R. *et al*.

[7] *See* Part 50 of the Commission Regulations.

[8] *See id*.

- The firm acts only on behalf of persons located outside the United States to trade commodity interests on or subject to the rules of a designated contract market ("DCM") or derivatives transaction execution facility; and

- Each commodity interest transaction is submitted for clearing through an FCM.[9]

When the Commission proposed this exemption, it did not refer to CTAs, CPOs, or IBs as it does now. Rather, the Regulation was initially proposed to apply only to "foreign brokers" and to exempt those firms from FCM registration.[10] At that time, the Commission sought to codify a definition of "foreign broker" and to clarify that – in keeping with the long-standing policy of the Commission and the former Commodity Exchange Authority – such a firm did not need to register as an FCM provided that it "submits customer or proprietary trades executed on or subject to the rules of U.S. markets for clearing on an omnibus basis through a fully registered FCM."[11] The Commission explained that this clearing condition was intended to preclude a foreign broker from "becom[ing] a remote clearing member of a derivatives clearing organization without having to register as an FCM," citing its concern "about oversight of clearing member firms because of the potential for systemic risk."[12]

The Commission determined to include CPOs and CTAs in Regulation 3.10(c)(3)(i) when it adopted the Regulation in final form. These additions were based on comments requesting the Commission "to provide greater legal certainty to futures market participants . . . that are not engaged in commodity interest activities on behalf of U.S. customers." In support of this change from the proposal, the Commission referred to its policy of focusing "'customer protection activities upon domestic firms and upon firms soliciting or accepting orders from domestic users of the futures markets.'"[13] That policy reflected the Commission's view "'that the protection of foreign customers of firms confining their activities to areas outside this country, its territories, and possessions may best be for local authorities in such areas.'"[14]

At the time it was proposed and adopted in 2007, the Regulation applied solely to futures and options on futures subject to the Commission's jurisdiction – contracts that historically have been required to be cleared through a derivatives clearing organization ("DCO"). Since the

[9] The Appendix to this letter includes the text of the Regulation in its proposed and final forms over recent years.

[10] 72 Fed. Reg. 15637 (Apr. 2, 2007) (proposing release).

[11] *Id.* at 15639.

[12] *Id.*

[13] 72 Fed. Reg. 63976, 63976-77 (Nov. 14, 2007) (adopting release), *quoting* 48 Fed. Reg. 35248, 35261 (Aug. 3, 1983).

[14] *Id.* The Commission also cited this policy position in the initial proposal for what ultimately became Regulation 3.10(c)(3)(i). *See* 72 Fed. Reg. at 15638.

Regulation was adopted in 2007, the Commission has gained jurisdiction over the swaps markets under the Dodd-Frank Act. For instance, that statute amended the CEA to include the term "swap" in the definitions of CTA, CPO, and commodity pool. In a similar fashion, the term "commodity interest" as defined in Regulation 1.3(yy) refers to swaps.

As part of further implementing the changes required by Dodd-Frank, in August 2012 the Commission finalized amendments to its registration requirements for intermediaries in Part 3 of its Regulations.[15] As relevant here, the Commission amended Regulation 3.10(c)(3)(i) 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").

When it first proposed those amendments in 2011, the Commission explained it was seeking "to expand the exemption to commodity interest transactions made on or subject to the rules of an SEF."[16] The expansion was proposed "to create uniformity in [the] treatment of commodity interest transactions that do not involve a U.S. customer, regardless of whether the transaction is made on a designated contract market or an SEF."[17] The Commission sought comment on "whether it should expand the existing exemption from registration to foreign brokers and other foreign intermediaries that execute a bilateral swap transaction and voluntarily clear it on a derivatives clearing organization on an omnibus basis."[18] When it finalized the amendments to the Regulation, the Commission indicated that it had not received any comments on this last point. As a result, the exemption was adopted substantially as proposed.

II. CEA's Clearing Requirement Supports Clearing When Supportable by the Swap's Characteristics

Pursuant to Section 2(h) of the CEA, the Commission must take into account the following factors when reviewing whether a swap – or any group, category, type, or class of swaps – should be required to be cleared:

- The existence of significant outstanding notional exposures, trading liquidity, and adequate pricing data.

- The availability of rule framework, capacity, operational expertise and resources, and credit support infrastructure to clear the contract on terms that are consistent with the material terms and trading conventions on which the contract is then traded.

[15] 77 Fed. Reg. 51898, 51899 (Aug. 28, 2012).

[16] 76 Fed. Reg. 12888, 12889 (Mar. 9, 2011).

[17] *Id.*

[18] *Id.* at 12889-90.

- The effect on the mitigation of systemic risk, taking into account the size of the market for such contract and the resources of the DCO available to clear the contract.

- The effect on competition, including appropriate fees and charges applied to clearing.

- The existence of reasonable legal certainty in the event of the insolvency of the relevant derivatives clearing organization or one or more of its clearing members with regard to the treatment of customer and swap counterparty positions, funds, and property.

Given these clearing standards combined with the history and context of Regulation 3.10(c)(3)(i), the Associations believe that the Commission did not intend to impose more onerous requirements upon Foreign Intermediaries relying upon Regulation 3.10(c)(3)(i)'s registration exemption. As Chairman Massad recently noted, the Commission's "goal is not just to increase the amount of clearing, our goal is to mandate clearing where we think it makes sense, meaning standardized swaps where we feel promoting clearing or mandating clearing can reduce the overall risk in the system."[19] The Associations submit that a broader clearing condition under Regulation 3.10(c)(3)(i)—even for swaps that have low liquidity or are not supported for clearing by DCMs—would be inconsistent with the Commission's overall policy objectives for clearing and mitigating systemic risk.

III. Factual Scenarios Under Which Registration Should Not Be Required for a Non-U.S. CPO or CTA Servicing Non-U.S. Persons

As explained above, the clearing condition was initially intended to preserve the Commission's ability to exercise proper oversight of clearing activities through its FCM registration regime. While Regulation 3.10(c)(3)(i) may continue to serve that purpose, the clearing condition, as applied to swaps, also presents practical challenges for Foreign Intermediaries. In particular, the clearing condition could disqualify a foreign manager or operator from relying on Regulation 3.10(c)(3)(i) if the foreign client seeks to trade a swap with a U.S. counterparty, where the swap either is not required to be cleared pursuant to Part 50 of the Commission's Regulations or is otherwise unable to be cleared. This outcome is contrary to the Commission's general purpose in adopting and amending Regulation 3.10(c)(3)(i), namely, to make registration relief available to foreign firms (through the addition of CPOs and CTAs) and to have it apply to trading of additional types of commodity interests (swaps, both traded bilaterally and on a SEF or a DCM).

In this regard, the Associations wish to raise for the Commission Staff's consideration the principal set of circumstances in which the clearing condition could limit Regulation

[19] Statement of Commission Chairman Timothy Massad at the Market Risk Advisory Committee (Nov. 2, 2015), *available at* https://www.youtube.com/watch?v=5qSM3467YVg&feature=youtu.be (1:53:28 to 1:53:44).

3.10(c)(3)(i)'s availability to a foreign entity that is not registered with the Commission as a CPO or a CTA:

> A non-U.S. operator or advisor sponsors or advises a Non-U.S. Person.[20] The non-U.S. operator or advisor seeks to enter into a swap transaction for the client's account with a U.S. person counterparty (including a U.S.-based swap dealer) or on a U.S.-based SEF. The swap either would not be subject to a mandatory clearing determination or would not be capable of being cleared voluntarily.

IV. Scope of Impact

For the Associations' members, the most broad and significant impact of the clearing condition is upon our U.S. members that provide advisory services to Foreign Intermediaries entering into swap transactions not subject to a Commission clearing requirement with U.S. person counterparties on behalf of Non-U.S. Persons.[21] For many of these transactions, the U.S. CTA must determine whether a Foreign Intermediary not registered with the Commission is required to be registered. If either the CTA or the U.S. person counterparty is acting in a registered capacity, it will be prohibited from doing business with non-members that are required to be registered with the Commission.[22] The U.S. members are not requesting any relief for their own registration requirements; rather, they seek to clarify the Foreign Intermediaries' registration status.

Separate and apart from such an advisory relationship, many of our members have Foreign Intermediaries as corporate affiliates, including members ranging from global asset managers with more than $1 trillion of assets under management to smaller asset managers serving non-U.S. clients that have a Foreign Intermediary affiliate who enters into swap transactions with U.S. person counterparties on behalf of Non-U.S. Persons. As such, the lack of harmony between the Commission clearing requirement under Part 50 and Regulation 3.10(c)(3)(i)'s clearing condition directly affects our members.

* * *

For these reasons, the Associations request that the Division not recommend an enforcement action against a person located outside the United States, its territories or possessions engaged in the activity of an IB, as defined in Commission Regulation 1.3(mm); a CTA, as defined in Commission Regulation 1.3(bb); or a CPO, as defined in Commission

[20] In each case, the Non-U.S. Person qualifies as an eligible contract participant under Section 1a(18) of the Commodity Exchange Act or Regulation 1.3(m).

[21] In each case, the pool qualifies as an eligible contract participant under Section 1a(18) of the Commodity Exchange Act or Regulation 1.3(m).

[22] *See* Bylaw 1101.

Regulation 1.3(nn), in connection with swaps not subject to a Commission clearing requirement[23] only on behalf of persons located outside the United States, its territories or possessions, for failure to register in such capacity.

In addition to requesting this relief, the Associations intend to petition the Commission for a permanent correction of the Regulation.

Should you have any questions or wish to discuss these matters further, please do not hesitate to contact Tim Cameron (202-962-7447 or tcameron@sifma.org), Laura Martin (212-313-1176 or lmartin@sifma.org), Robert Grohowski (202-507-7209 or Robert.grohowski@investmentadviser.org), Monique Botkin (202-507-7207 or monique.botkin@investmentadviser.org) or Joshua Sterling, Morgan, Lewis & Bockius LLP (202-739-5126 or jsterling@morganlewis.com).

Respectfully submitted,

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cc: Frank Fisanich, Chief Counsel
Katherine Driscoll, Associate Chief Counsel
Greg Scopino, Special Counsel
Joshua Sterling, Morgan, Lewis & Bockius LLP

[23] *See* Part 50 of Commission Regulations.

APPENDIX I

Certification Pursuant to Commission Regulation §140.99(c)(3)

As required by Commission Regulation §140.99(c)(3), we hereby (i) certify that the material facts set forth in the attached letter dated February 2, 2016 are true and complete to the best of our knowledge; and (ii) undertake to advise the Commission, prior to the issuance of a response thereto, if any material representation contained therein ceases to be true and complete.

Respectfully submitted,

/s/ Tim Cameron
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Asset Management Group – Head
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/s/ Laura Martin
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Managing Director and Associate General Counsel
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APPENDIX II

TEXT OF REGULATION 3.10(C)(3)(I)

Proposed – April 2, 2007

§ 3.10 Registration of futures commission merchants, introducing brokers, commodity trading advisors, commodity pool operators and leverage transaction merchants.

(c) *Exemption from registration for certain persons.*

(2)(i) A foreign broker, as defined in § 1.3(xx) of this chapter, is not required to register as a futures commission merchant if it submits any commodity interest transactions executed on or subject to the rules of designated contract market or derivatives transaction execution facility for clearing on an omnibus basis through a futures commission merchant registered in accordance with section 4d of the Act.

Adopted – November 14, 2007

§ 3.10 Registration of futures commission merchants, introducing brokers, commodity trading advisors, commodity pool operators and leverage transaction merchants.

(c) *Exemption from registration for certain persons.*

(3)(i) A person located outside the United States, its territories or possessions engaged in the activity of: An introducing broker, as defined in § 1.3(mm) of this chapter; a commodity trading advisor, as defined in § 1.3(bb) of this chapter; or a commodity pool operator, as defined in § 1.3(nn) of this chapter, in connection with any commodity interest transaction made on or subject to the rules of any designated contract market or derivatives transaction execution facility only on behalf of persons located outside the United States, its territories or possessions, is not required to register in such capacity: Provided, that any such commodity interest transaction executed on or subject to the rules of designated contract market or derivatives transaction execution facility is submitted for clearing through a futures commission merchant registered in accordance with section 4d of the Act.

Proposed Amendment – March 9, 2011

§ 3.10 Registration of futures commission merchants, introducing brokers, commodity trading advisors, commodity pool operators and leverage transaction merchants.

(c) *Exemption from registration for certain persons.*

(3)(i) A person located outside the United States, its territories or possessions engaged in the activity of: An introducing broker, as defined in § 1.3(mm) of this chapter; a commodity trading advisor, as defined in § 1.3(bb) of this chapter; or a commodity pool operator, as defined in

§ 1.3(cc) of this chapter, in connection with any commodity interest transaction made on or subject to the rules of any designated contract market or swap execution facility only on behalf of persons located outside the United States, its territories or possessions, is not required to register in such capacity provided that any such commodity interest transaction executed on or subject to the rules of designated contract market or swap execution facility is submitted for clearing through a futures commission merchant registered in accordance with section 4d of the Act.

Final Amendment – August 28, 2012

§ 3.10 Registration of futures commission merchants, introducing brokers, commodity trading advisors, commodity pool operators and leverage transaction merchants.

(c) *Exemption from registration for certain persons.*

(3)(i) A person located outside the United States, its territories or possessions engaged in the activity of: An introducing broker, as defined in § 1.3(mm) of this chapter; a commodity trading advisor, as defined in § 1.3(bb) of this chapter; or a commodity pool operator, as defined in § 1.3(nn) of this chapter, in connection with any commodity interest transaction executed bilaterally or made on or subject to the rules of any designated contract market or swap execution facility only on behalf of persons located outside the United States, its territories or possessions, is not required to register in such capacity provided that any such commodity interest transaction is submitted for clearing through a futures commission merchant registered in accordance with section 4d of the Act