WASHINGTON watch

House Passes CFTC Reauthorization Bill

On June 24, the House of Representatives passed H.R. 4413, the Customer Protection and End User Relief Act, a bill to reauthorize the Commodity Futures Trading Commission through September 2018 and modify certain authorities of the CFTC within the Commodity Exchange Act. The legislation was approved by a vote of 265 to 144.

Walt Lukken, president and CEO of FIA, commended lawmakers for their bipartisan work on the legislation. "As derivatives markets are adapting and responding to major regulatory changes, they need stability and certainty to thrive, and the House Agriculture Committee leadership recognized this as they developed H.R. 4413," he said.

In addition to continuing the CFTC's authorization, the House bill would also make the following modifications to the Commodity Exchange Act:

- Stipulates congressional expectations for the protection of customer assets by statutorily codifying some recent regulatory enhancements, such as daily confirmations of segregated balances.
- Clarifies congressional intent as to the point in time when futures commission merchants are required to deposit residual interest to satisfy the margin deficits of their customers.
- Ensures that customers are a high priority when claims are made for recovery of assets even if the customer funds accounts are insufficient to cover their losses.
- Revises the organizational and operational workings of the CFTC by modifying the reporting structure for CFTC division directors, requiring them to report to the full commission rather than only the CFTC chairman. The bill also establishes a specific process for staff actions such as "no-action" letters and staff guidance.
- Changes the manner in which cost-benefit analysis is performed for future CFTC rulemakings.
- Requires joint cross-border swap/security-based swap rulemaking by the CFTC and the Securities and Exchange Commission that would limit regulatory reach into certain jurisdictions with broadly equivalent swap regulations
- Fine-tunes various authorities granted in the Dodd-Frank Act relative to CFTC swap regulations:
  - Exempts non-financial entity end-users from margin requirements for those swaps not subject to mandatory clearing requirements.
  - Provides relief from specific communication recording requirements for certain agricultural and commercial entities.

The legislation has been referred to the Senate and the Senate Agriculture Committee. Once the full Senate has passed a bill, the House and Senate will seek to reconcile differences in each version of the bill and then send a unified measure back to both the House and Senate for approval and ultimately to the President who will consider signing it into law. If this process is not completed prior to the seating of a new Congress next January, the process will start all over under the next Congress.

U.S. Lawmakers Introduce Bill Modifying CFTC Customer Protection Rules

On July 15 Senators Pat Roberts (R-Kansas) and Heidi Heitkamp (D-N.D.) introduced a bill (S. 2601) intended to offer relief to futures customers by modifying the so-called residual interest requirements in the customer protection rules that the Commodity Futures Trading Commission finalized in 2013.

The legislation addresses the point in time when futures commission merchants are required to deposit residual interest to satisfy the margin deficits of their customers, thereby providing sufficient time for customers to meet margin calls.

The bill mirrors legislation (H.R. 4413) which passed on June 25 in the House of Representatives.

SEC Adopts Rules for Cross-Border Security-Based Swaps

The Securities and Exchange Commission on June 25 approved rules and guidance on cross-border security-based swap activities. It was the first in a series of rules to be approved that relate to how SEC regulations apply to cross-border security-based swap transactions and participants in these markets.

The rules and guidance explain when a cross-border transaction must be counted toward the SEC requirement to register as a security-based swap dealer or major security-based swap participant. The rules also address the scope of the SEC's cross-border anti-fraud authority.

The SEC also adopted a rule regarding so-called substituted compliance requests, establishing a procedure for market participants to satisfy certain obligations by complying with comparable foreign regulatory requirements.

The rules detail, among other things, the criteria for when foreign firms are covered by the SEC's regulatory regime. They specify when market participants engaged in cross-border swaps activity would be subject to SEC regulation as dealers or major participants and they define a number of key terms such as a U.S. person.

Mary Jo White, chairwoman of the SEC, said the rules were strengthened from the SEC's 2013 proposal. White said they include "robust additional limits on unregulated activity by U.S. firms acting through their branches and affiliates established abroad as well as enhancements to ensure that private funds do not circumvent the intended ambit of Title VII."

White highlighted that one aspect of the rule requires that a guaranteed foreign affiliate of a U.S. person must now consider all of its security-based swap activity subject to a U.S. guarantee in assessing whether it is a dealer within the SEC's oversight. "Where there is a guarantee in place with respect to that activity, there are no distinctions for

these purposes between activity directed toward the U.S. and activity directed abroad," White said.

In addition, White highlighted that the rule clarifies what constitutes a guarantee. "In general, a U.S. person guarantees any security-based swap where there is a legally enforceable right of recourse against the U.S. person—conditional or unconditional, in whole or in part, oral or written, by contract or statute," White said.

The rules became effective in September. However, the application of the dealer and major participant definitions and the procedures for submitting substituted compliance requests will not be imposed until other relevant rulemakings have been finalized, the SEC said.

Treasury's FinCEN Proposes Ownership Identification Rule

The Financial Crimes Enforcement Network, the anti-money laundering arm of the U.S. Treasury Department, issued a "notice of proposed rulemaking" on July 30 that would require financial institutions to verify the identities of the beneficial owners of the companies for which they provide services.

The proposed requirement would apply to futures commission merchants and introducing brokers. As proposed, FCMs and IBs would be required to identify and verify any individual who owns 25% or more of a legal entity that is a customer.

The proposed requirement includes certain exemptions that may limit the impact, however. For example, the proposed requirement would apply only to new accounts and would not look through omnibus accounts.

Treasury will accept comments on the proposal for 60 days after publication in the *Federal Register*.

FIA commented on a previous version of the proposal in October 2012. In that comment FIA urged FinCEN to take into account "the complexities and unique nature of the futures industry," such as the widespread use of give-up transactions. FIA also provided FinCEN with an explanation of the omnibus account structure and urged FinCEN to allow FCMs to treat intermediaries as their customers for the purpose of customer identification.

FIA Seeks Clarification on Ukraine Sanctions

FIA submitted a letter on Aug. 1 to the Office of Foreign Assets Control, a division of the U.S. Treasury Department, to provide information concerning the role of a futures commission merchant in managing its customer positions in the futures markets and the potential market impact if an FCM customer with open positions becomes the subject of asset-blocking sanctions.

FIA's comments were in response to regulations setting out sanctions that Treasury's OFAC issued earlier this year in response to the ongoing crisis in Ukraine.

"We understand that the Regulations would not permit a futures commission merchant to liquidate the accounts of customers that are subject to asset-blocking sanctions, absent either a general or specific license that would permit such liquidation through offsetting transactions," FIA wrote in its letter. FIA warned that the financial integrity of the cleared derivatives markets depends on the ability of an FCM to collect required margin from its customers, transmit required margin to the derivatives clearing organization and liquidate in an orderly manner.

In addition, FIA asked OFAC to consider adding a general license to the regulations implementing the Ukraine sanctions that would allow an FCM to liquidate the open

FIA Suggests Changes to CFTC Position Aggregation Rule

On July 31, FIA submitted a comment letter to the Commodity Futures Trading Commission providing additional comment on the agency's proposed position aggregation rule. FIA suggested nine changes that would address concerns raised by FIA members and other market participants. These changes include:

- Expanding the scope of the owned entity exemption to allow the disaggregation of all owned entities when the owner and owned entity meeting the conditions proposed for minority owned entities and do not control or have knowledge of the trading decisions of the other.
- Clarifying that the condition to adopt policies and procedures to restrict knowledge of trading only applies to the owner claiming the exemption
- Incorporating into the rule the CFTC's guidance from the proposed aggregation rule that the owned entity exemption does not restrict the owner and the owned entity from sharing information or employees related to risk management, accounting, compliance or similar mid- and back-office functions;
- Permitting registered broker-dealers to disaggregate any ownership interest predicated on the ownership of securities acquired in the normal course of business as a dealer without regard to the level of ownership.
- Adopting an exemption from aggregation for transitory ownership or equity interests in an owned entity, such as those acquired through foreclosure or a similar credit event.
- Permitting a market participant that otherwise qualifies for an exemption from aggregation to rely upon the exemption during a 90-day period before filing the required notice with the CFTC.
- Clarifying that if a market participant otherwise qualifies for an exemption from aggregation, but does not provide timely notice to the CFTC, the failure to provide such notice does not result in a separate violation of speculative position limits.
- Making conforming changes to the proposed rule-text to clarify that the owned entity exemption requires that the owner and the owned entity trade pursuant to independent trading "strategies" rather than "systems."
- Continuing to provide a process that allows for timely responses to non-enumerated hedge exemption applications and rely on the expertise of the exchanges to recognize non-enumerated hedge exemptions.

positions of a customer that is a target of the sanctions or allow a clearinghouse to liquidate the open positions of a customer if the FCM is in default.

CFTC Issues Temporary Relief from Certain OCR Reporting Requirements

The Commodity Futures Trading Commission's division of market oversight on July 23 issued a no-action letter providing additional time for reporting parties to comply with new electronic reporting requirements under the agency's ownership and control reporting rules.

The OCR rule requires the electronic submission of trader identification and market participant data on new and updated reporting forms. The relief was issued in response to a June 6 letter from FIA asserting that the industry needed more time to build and test systems as well as educate clients and collect data. The OCR rule was set to take effect on Aug. 15.

The CFTC's no-action letter extends implementation of the reporting requirements as follows:

- Electronic reporting via Form 102A and Form 1028 will take effect on Feb. 11, 2015.
- Electronic reporting via Form 102B will take effect on March 11, 2015.
- Electronic reporting via Form 40/408 and Form 71 will take effect on Feb. 11, 2016.

FIA has been working with clearing firms and other market participants to help the industry comply with the new requirements. The FIA Chicago division held a panel discussion on OCR compliance on June 16 with speakers from CME Group, Foley & Lardner, Intercontinental Exchange and Newedge, and FIA Tech is developing a web-based application that will provide a uniform method of capturing, storing and reporting customer data to the CFTC.

CFTC Responds to FIA Request for Relief from Certain Customer Funds Requirements

The Commodity Futures Trading Commission's division of swap dealer and intermediary oversight on June 25 issued a letter extending no-action relief to futures commission merchants until Oct. 31 for compliance with certain conditions related to an FCM's receipt and recording of customer funds required under CFTC Regulations 1.20, 22.2 and 30.7. The relief was set to expire on June 30.

FIA in a June 12 letter requested the extension, cautioning that the conditions set forth by the CFTC in its customer funds regulations that permit a customer to submit a single wire transfer to fund multiple account origins presents serious operational and technological challenges. "FCMs still do not have the technology that allows for the simultaneous book entry credit to a customer's 30.7 account or cleared swaps customer account upon receipt and recording of funds into the customer's section 4d(a)(2) account," FIA wrote, adding that FCM systems allow only for batch processing throughout the day.

FIA noted that since the division's original Jan. 10 no-action letter, FIA and its member firms have been in frequent contact with division staff and that CFTC staff have developed initial recommendations regarding the issues raised in FIA's letter. "We appreciate the staff's considerable efforts to date and do not want to see their work cut short unnecessarily," FIA wrote.