

National Futures Association Bylaw 1101

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April 21, 2016 | 10:00 AM ET | Webinar

Presenter: Steve Humenik of Covington & Burling LLP



38th Annual FIA Law & Compliance Conference

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OTC Margin Rules: US & EU Perspectives

May 24, 2016 | 10:00 AM ET | Webinar

Presenter: Claude Brown, Ilene Froom and Peter Malyshev of Reed Smith

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A question and answer period will conclude the presentation.

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NFA Bylaw 1101

- Put simply, an NFA member
 - may not do business with a non-member
 - that is required to be registered with the CFTC
 - but is not.

NFA Bylaw 1101

- Section 17(m) of the Commodity Exchange Act
 - Registered futures associations may adopt mandatory membership rules
- CFTC Part 170 Rules
 - CFTC registrants must become and remain members of a registered futures association
 - In 1983, the CFTC adopted Rule 170.15 to cover FCMs
 - In 2012, the CFTC adopted Rule 170.16 to cover swap dealers and major swap participants
 - In 2015, the CFTC adopted Rule 170.17 to cover CPOs, CTAs and IBs

NFA Bylaw 1101

- Bylaw 1101 adopted in 1981
- Prohibition included in NFA Articles of Incorporation
 - Article III, Section 1(f)
 - Doing Business With Non-Members
 - Intended to help NFA effectuate its purposes of promoting the improvement of business conditions and the common business interests of persons engaged in commodity futures and swaps or related activity

NFA Bylaw 1101

- No Member may carry an account, accept an order or handle a transaction in commodity futures contracts for or on behalf of any non-Member of NFA, or suspended Member, that is required to be registered with the Commission as an FCM, IB, CPO, CTA or LTM, and that is acting in respect to the account, order or transaction for a customer, a commodity pool or participant therein, a client of a commodity trading advisor, or any other person...

What is “Doing Business”?

- FCM
 - carrying an account
 - clearing trades on behalf of a CTA’s clients
 - charging a commodity pool brokerage commissions
- CPO
 - accepting a fund as an investor
- CTA
 - advising a commodity pool or other entity
 - directing trades in the commodity pool’s account

Swap Dealers and Major Swap Participants

- CFTC Rule 170.16
 - Effectively requires NFA membership for swap dealers and major swap participants
- Swap dealers and major swap participants are not expressly subject to Bylaw 1101
- Whether NFA will amend Bylaw 1101 to expressly include swap transactions remains to be seen

Bylaw 1101

- Other circumstances that may implicate Bylaw 1101:
 - CFTC’s proposed Regulation Automated Trading
 - Proposed Rule 170.18 would require “AT Persons” to become and remain members of NFA
 - Branch offices
 - Branch offices that are separately incorporated entities are required to be registered with the CFTC as introducing brokers and members of NFA
 - Trading systems
 - Members that provide execution services to users of computer trading systems developed by a third-party system developer must determine whether such system developer should be registered with the CFTC as a CTA and a member of NFA

Self-Policing Bylaw

- Bylaw 1101 is an industry self-policing bylaw
- By its terms, strict liability
- Generally, NFA's practice has not been to hold members strictly liable for Bylaw 1101 infractions

Good Faith Effort

- NFA will look at whether the member
 - knew or should have known
 - that the person was not registered
 - and should have been
- Good faith compliance
 - adequate diligence
 - adequate policies and procedures

NFA Guidance

- NFA guidance June 2012
 - Members must check each counterparty annually

- NFA guidance April 2015
 - Members must determine whether investment management authority has been delegated for a pool

NFA Guidance

- Recurring NFA guidance on conducting business with persons required to annually affirm an exemption or exclusion
 - Members given limited relief from Bylaw 1101 if a previously exempt counterparty fails to become registered and a member of NFA or affirm an exemption or exclusion in a timely manner

Compliance with Bylaw 1101

- Representations in agreements
 - Trading advisory
 - Pool subscription
 - Brokerage
- Termination clauses
- Contractual terms alone not sufficient without related diligence

Compliance with Bylaw 1101

- Policies and procedures for:
 - Determining whether registration is required for (or an exemption/exclusion is available to) a customer or counterparty
 - Determining whether such person is registered with the CFTC and a member of NFA
- Ongoing diligence
- Process documented and records maintained

Compliance with Bylaw 1101

- CFTC annual affirmation requirement
 - Persons claiming an exemption from registration under Rule 4.13 or 4.14(a)(8) or an exclusion from the definition of CPO under Rule 4.5 must file a notice annually
- Where appropriate, CPOs of investee pools must annually confirm whether the assumed exempt CPO of a collective investment vehicle investor has timely filed an affirmation

NFA Disciplinary Actions

- NFA's Business Conduct Committee has brought enforcement actions against NFA members for violations of Bylaw 1101
 - Members of the BCC use their “informed business judgment” in determining whether to bring an action against a member
- E.g., Interactive Brokers LLC (2012) and TNT Investments, Inc. (2010)

NFA Disciplinary Actions

- Interactive Brokers – summary of case
 - Registered with CFTC as an FCM
 - Allegedly permitted unregistered and non-exempt CPOs to trade commodity pool accounts at Interactive
 - According to complaint, Bylaw 1101 violations resulted from (i) inadequate procedures and (ii) failure of firm personnel charged with reviewing new account applications to conduct sufficient inquiry into CFTC registration and NFA membership status of proposed account holders prior to opening new accounts

NFA Disciplinary Actions

- Interactive Brokers – summary of case (cont.)
 - Interactive fined \$300K
 - Required to implement enhanced written procedures to ensure compliance with Bylaw 1101

NFA Disciplinary Actions

- TNT Investments – summary of case
 - Registered with CFTC as CPO, CTA and IB
 - Allegedly received customer referrals from a non-member that was required to be registered as an IB
 - According to the complaint, TNT Investments permitted customers referred to it by a non-member to invest in its commodity pools; in return, TNT Investments paid referral fees to the non-member
 - TNT Investments fined \$75K

Questions?

Please use the “question” function on your webinar control panel to ask a question to the moderator or speakers.

For more information please contact:

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Thank you.



FIA

The logo consists of three characters: 'F', 'I', and 'A'. The 'F' is a solid dark grey blocky letter. The 'I' is a solid dark grey vertical bar. The 'A' is composed of several overlapping geometric shapes: a light green triangle on the left, a blue triangle on the right, and a blue horizontal bar at the bottom. The background features a network of thin grey lines forming a grid of irregular polygons.