

NFA Adopts Swaps Associated Person Proficiency Requirements

March 18, 2019

On March 5, 2019, the National Futures Association (“NFA”) submitted to the Commodity Futures Trading Commission (the “Commission” or “CFTC”) amendments to NFA Bylaw 301 and NFA Compliance Rule 2-24 and an associated Interpretative Notice (the “Amendments”), which will require certain associated persons (“APs”) of NFA member futures commission merchants (“FCMs”), introducing brokers (“IB”), commodity pool operators (“CPOs”), and commodity trading advisors (“CTAs,” together with FCMs, IBs and CPOs, “Intermediaries”) engaged in swaps activity, as well as APs of swap dealers (“SDs”) and major swap participants (“MSPs”), to satisfy swap proficiency requirements (“Swap Proficiency Requirements”).¹ The purpose of the Swap Proficiency Requirements is to ensure that APs engaged in swaps activities meet a minimum proficiency standard that tests both their market knowledge and their knowledge of regulatory requirements relating to swaps activities. The Amendments do not, however, require APs of SDs or MSPs to register with NFA. The NFA has indicated it intends to make the Amendments effective beginning January 31, 2020 with a compliance date of January 31, 2021. The following Memorandum provides a brief overview of the Amendments and identifies key issues raised by the Amendments.

If you have any questions concerning this memorandum, please reach out to your regular firm contact or the following authors

NEW YORK

Colin D. Lloyd
+1 212 225 2809
clloyd@cgsh.com

Brian J. Morris
+1 212 225 2795
bmorris@cgsh.com

Brandon J. Hill
+1 212 225 2331
bhill@cgsh.com

¹ Letter from Carol Wooding, Vice President and General Counsel, National Futures Association, to Christopher Kirkpatrick, Secretary, Office of the Secretariat, Commodity Futures Trading Commission (March 5, 2019), (“NFA Letter”) available at: <https://www.nfa.futures.org/news/PDF/CFTC/InterpNotcNFABylaw301CR2-24ProficiencyRequirementsSwapAPs.pdf>.

clearygottlieb.com



© Cleary Gottlieb Steen & Hamilton LLP, 2019. All rights reserved.

This memorandum was prepared as a service to clients and other friends of Cleary Gottlieb to report on recent developments that may be of interest to them. The information in it is therefore general, and should not be considered or relied on as legal advice. Throughout this memorandum, “Cleary Gottlieb” and the “firm” refer to Cleary Gottlieb Steen & Hamilton LLP and its affiliated entities in certain jurisdictions, and the term “offices” includes offices of those affiliated entities.

Scope of APs Covered by the Swap Proficiency Requirements

Intermediaries. The Amendments will apply to NFA member Intermediaries engaged in CFTC-regulated swaps activities (“Swap Intermediary Firms”) and APs of such Swap Intermediary Firms (“Swap Intermediary APs”). Currently, Swap Intermediary Firms and Swap Intermediary APs must be approved by NFA, and the Amendments will require Swap Intermediary APs to comply with the new Swap Proficiency Requirements prior to being granted approval as Swap Intermediary APs.

Note that under NFA Bylaw 301(l)(iii), at least one principal of each Intermediary that is a Swap Intermediary Firm must be registered as a Swap Intermediary AP and accordingly, that principal will be subject to the Swap Proficiency Requirements.

SDs and MSPs. APs of SDs and MSPs will also be subject to Swap Proficiency Requirements. Unlike Swap Intermediary APs, APs of an SD or MSP are not required to register with the CFTC, and APs of an SD or MSP are not NFA associate members directly subject to NFA's jurisdiction. Accordingly, under the Amendments, it is the responsibility of the SD or MSP to ensure that any individual acting as an AP has satisfied NFA's Swaps Proficiency Requirements.

Because APs of SDs are not subject to registration, such personnel are currently identified primarily for the purpose of conducting background checks. Going forward, SDs may wish to re-examine the process for identification of APs, as such personnel will be subject to Swap Proficiency Requirements. The Amendments recognize that not all Swap APs of an entity are employed by that entity and would

apply Swap Proficiency Requirements to APs employed by affiliates. SDs and MSPs may want to review the designation of such personnel as APs and consider possible alternatives, such as reliance on relief from IB or CTA registration under CFTC Letter 12-70.²

The Amendment's Interpretive Notice exempts from the Swap Proficiency Requirements any APs of an SD or MSP located outside the U.S., including at non-U.S. branch offices of a U.S. SD, who solely solicit or accept swaps with counterparties that are non-U.S. persons and/or non-U.S. branch offices of U.S. SDs.

NFA notes in its explanatory letter accompanying the Amendments that this exclusion is based on a similar exemption from registration for APs of an Intermediary under CFTC Regulation 3.12(h)(iv), the Commission's 2013 cross-border interpretive guidance and policy statement,³ and the Commission's 2016 proposed rules exploring the cross-border application of the Commission's external business conduct rules to SDs.⁴

Swap Proficiency Requirements

The Swap Proficiency Requirements are designed to test both market knowledge and knowledge of regulatory requirements relating to swaps activities. The process will involve an online training program followed by related test questions. In recognition of the fact that there are differences in the type of swaps activity performed by APs, NFA has developed two proficiency tracks—a “Long Track” and a “Short Track”.

Long/Short Track. The Long Track consists of eight modules: swaps products and applications, regulation of the swaps market, onboarding, transactional

² CFTC No-Action Letter No. 12-70 (December 31, 2012).

³ Interpretive Guidance and Policy Statement Regarding Compliance With Certain Swap Regulations, 78 Fed. Reg. 45292 (July 26, 2013).

⁴ Cross-Border Application of the Registration Thresholds and External Business Conduct Standards Applicable to Swap Dealers and Major Swap Participants, 81 Fed. Reg. 71946 (October 18, 2016).

disclosures, swap dealer anti-fraud and ethical practices, trade execution/clearing/margin, risk management and supervision. It is expected that the Long Track program will take approximately eight hours to complete in total, but each module can be completed independently.

The Short Track consists of four modules: swaps products and applications, regulation of the swaps market, supervision and intermediary compliance, anti-fraud and other requirements. It is expected that the Short Track program that will take approximately four hours to complete in total, but like the Long Track, each module can be completed independently.

NFA has not yet provided detail regarding the content of the Long Track and Short Track programs beyond the description of modules identified above, although NFA has indicated that a general Q&A will be made available on NFA's website. As of the publication date of this Memorandum, the Q&A is not available.

AP Eligibility for Long/Short Track. SDs must ensure that individuals designated as APs in the sales and trading areas who negotiate, price and/or execute swaps with counterparties on behalf of the SD and/or manage the SD's swaps related risks ("Sales and Trading APs") complete the Long Track program. Additionally, SDs must ensure that APs who are responsible for supervising Sales and Trading APs satisfy the Long Track program.

An SD that has designated APs who perform functions other than those of a Sales and Trading AP or an AP who supervises non-Sales and Trading APs ("Non-Sales and Trading APs") has the option of permitting those individuals to satisfy either the Long Track or the Short Track program. SDs also have the option to permit APs who are responsible for supervising Non-Sales and Trading APs to satisfy the Long Track or the Short Track. However, if the responsibilities of any AP who has satisfied the Short Track expands to include activities requiring designation as a Sales and Trading AP, including supervising Sales and Trading

APs, the SD must ensure that such AP satisfies the Long Track before engaging in these new activities.

NFA helpfully permits flexibility in satisfying the Swap Proficiency Requirements by recognizing the more limited responsibilities of Non-Sales and Trading APs and permitting such APs to satisfy the Short Track program. SDs who take advantage of this flexibility by not requiring all APs to satisfy the Long Track program should establish appropriate distinctions between Sales and Trading APs and Non-Sales and Trading APs, track the designation of such APs, and review AP responsibilities and activities in order to track potential changes in eligibility for the Short Form program.

Swap Intermediary APs, on the other hand, are only required to satisfy the Short Track, including individuals responsible for supervising Swap Intermediary APs.

Duration of Swap Proficiency Requirement and Associated SD/MSP Recordkeeping Requirements

As noted above, satisfying proficiency requirements is a condition for registration of Swap Intermediary APs. However, because APs of SDs are not subject to registration, SDs are responsible to ensure their APs satisfy the applicable Swap Proficiency Requirements. To ensure compliance with those requirements, the Amendments require that the SD or MSP maintain records that demonstrate that its APs have satisfied NFA's Swap Proficiency Requirements and require the SD or MSP to be able to provide those records to NFA during an NFA examination or otherwise upon request. Examples of adequate documentation include a log identifying APs and dates of completion or copies of the certificate of completion that an AP will receive upon successfully completing NFA's swaps proficiency requirements.

Generally, there is no obligation for an AP who has satisfied the Swap Proficiency Requirement to complete the program again or otherwise renew his or

her certification. However, consistent with NFA's other proficiency requirements, the Amendments do require individuals to satisfy the Swaps Proficiency Requirements again in order to be able to engage in swap activities as an AP if such individual ceases being approved as a Swap Intermediary AP of a Swap Intermediary Firm that is a member of NFA, or ceases being employed by an SD (or its affiliated entity), for a continuous period of more than two years.

The additional recordkeeping requirement for SDs and MSPs will create the need for the adoption of new policies and procedures to track and monitor AP activity, including the conditions upon which an SD or MSP may reasonably rely on documentation or certifications provided by its employee or prospective employee showing continued employment and/or satisfaction of proficiency program requirements that originate from an unaffiliated firm (e.g., where an AP changes employment).

Compliance Date

The compliance date to complete the Swap Proficiency Requirements is January 31, 2021 for all individuals approved as Swap Intermediary APs, or who are acting as APs at an SD or MSP on the Compliance Date. The rule does not provide for any grandfathering of existing APs. Following January 31, 2021, APs of an SD or MSP must satisfy Swap Proficiency Requirements prior to acting as an AP, and any individual seeking approval as a Swap Intermediary AP must satisfy NFA's swaps proficiency requirements prior to being approved as a Swap Intermediary AP and engaging in swap activities.

...

CLEARY GOTTlieb

Appendix A

Impact of the Amendments for APs				
Registrant	APs Subject to Swap Proficiency Requirements	Required to Complete Program (Type)	Duration of Program	APs subject to NFA Registration
SDs/MSPs	Sales and Trading APs of SDs/MSPs (or supervisor)	YES (Long Track ⁵)	8 hours in total, but each module can be completed independently	NO
	Non-Sales and Trading APs of SDs/MSPs (or supervisor)	YES (Short Track ⁶ or Long Track)	4 hours (Short Track) or 8 hours (Long Track) in total, but each module can be completed independently	NO
	APs of SDs located outside the U.S. with counterparties located outside the U.S. (or supervisor)	NO	N/A	NO
Intermediaries engaged in swaps activities	APs not engaged in swaps activities	NO	N/A	YES
	APs engaged in swaps activities	YES (Short Track)	4 hours in total, but each module can be completed independently	YES
Intermediaries not engaged in swaps activities	N/A	NO	N/A	YES

⁵ The Long Track consists of eight modules: Swaps Products and Applications, Regulation of the Swaps Market, Onboarding, Transactional Disclosures, Swap Dealer Anti-Fraud and Ethical Practices, Trade Execution/Clearing/Margin, Risk Management, and Supervision.

⁶ The Short Track consists of four modules: Swaps Products and Applications, Regulation of the Swaps Market, Supervision and Intermediary Compliance, and Anti-Fraud and Other Requirements.