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# CFTC Staff Issues Further Guidance and Relief Regarding Treatment of Separate Accounts by FCMs

[32763]

September 17, 2020 TO: Derivatives Markets Advisory Committee
Investment Advisers Committee RE: CFTC Staff Issues Further Guidance and Relief Regarding Treatment of Separate Accounts by FCMs

On September 15, 2020, The Division of Clearing and Risk (DCR) and the Division of Swap Dealer and Intermediary Oversight (DSIO) of the Commodity Futures Trading Commission (CFTC) issued Letter No. 20-28, which provides further guidance and time-limited no-action relief regarding the treatment of separate accounts by futures commission merchants (FCMs).[1] The letter, which is summarized below, supplements the guidance and extends the relief provided by the CFTC staff last year in CFTC Letter No. 19-17.[2]

## Background

CFTC Letter No. 19-17 provided guidance regarding CFTC Regulation 1.56(b)[3] and time-limited no-action relief regarding the application of CFTC Regulation 39.13(g)(8)(iii)[4] as those regulations relate to the treatment of separate accounts of the same beneficial owner customer of an FCM. In Letter No. 19-17, DSIO provided guidance that, in accordance with Regulation 1.56(b), FCM customer agreements or other documents must not: (i) preclude the FCM from calling the beneficial owner of an account for required margin; (ii) in the event the beneficial owner fails to meet the margin call, preclude the FCM from initiating a legal proceeding to recover any shortfall; or (iii) otherwise guarantee a beneficial owner against, or limit a beneficial owner's, loss. The letter stated that, to address any shortfall, the FCM must retain the ability to ultimately look to funds in other accounts of the beneficial owner, including accounts that may be under different control, as well as the right to call the beneficial owner for additional funds.

That letter also provided time-limited no-action relief until June 30, 2021 from the requirements of Regulation 39.13(g)(8)(iii) to a DCO if it permits its FCM clearing members to treat the separate accounts of their customer as accounts of separate entities for purposes of Regulation 39.13(g)(8)(iii), provided that the FCM's written internal controls and procedures require it to, and it does in fact, comply with a series of extensive conditions set out in the letter.

In response to industry requests for clarification of the guidance and extension of the relief provided in Letter No. 19-17, the Directors of DCR and DSIO in September 2019 issued a public statement ("2019 public statement") expressing their view that no further clarification regarding Letter No. 19-17 was necessary and that they expected efforts to comply with the requirements of Regulation 1.56(b) to be concluded by September 15, 2020.[5] The Directors noted that the statement in Letter No. 19-17 that "the FCM must retain the ability ultimately to look to funds in other accounts of the beneficial owner, including accounts that may be under different control," and the statement in Joint Audit Committee Alert 19-03 that "the FCM must have at all times the absolute right to look to funds in all accounts of the beneficial owner, including accounts that are under different control,"[6] were not inconsistent "if they are interpreted properly."

In the 2019 public statement, the Directors stated that they would not be extending the timeline "at any point." They encouraged DCOs and FCMs and their customers "to work together and to rely on their professional advisors as necessary to meet the expectations that we have laid out for them."

## CFTC Letter No. 20-28

In light of the COVID-19 pandemic, Letter No. 20-28 provides time-limited no-action relief until March 31, 2021 to an FCM to the extent that: (i) the FCM has not yet complied with the conditions of relief with respect to Regulation 39.13(g)(8)(iii) in Letter No. 19-17, or (ii) despite Regulation 1.56, the FCM has agreements that limit recourse to the account owner, including between separate accounts of the same customer. The Divisions 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)

or any account under rules analogous to Regulation 1.56. The Divisions also note that, after March 31, 2021, any cases where either of the Divisions discovers that an FCM is not in compliance with Regulation 1.56 will be referred to the Division of Enforcement.

Letter No. 20-28 extends the no-action relief provided in Letter No. 19-17 with respect to Regulation 39.13(g)(8)(iii) for an additional six months until December 31, 2021. The letter provides that, if it takes longer for the CFTC staff to recommend, and the Commission to determine whether to conduct and conduct, a rulemaking to implement appropriate relief on a permanent basis, the Divisions will consider a further extension of this timeframe.

Letter No. 20-28 further includes an interpretation of Regulation 1.56(b) that:

- 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. The letter clarifies that 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 the provisions prohibited by Regulation 1.56(b) would be compliant—an FCM need not have additional provisions regarding its rights against the beneficial owner in the agreement.
- As provided in the 2019 public statement, 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. The FCM, however, 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.

- Recognizes that 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. The letter clarifies that 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.

In addition, Letter No. 20-28 addresses situations in which compliance with Regulation 1.56 is ambiguous, providing that:

- *Mitigating Legal Risk*. If a statement in an FCM customer agreement entered into before March 31, 2021 can be construed as a representation to limit recourse inconsistent with Regulation 1.56(b), but the FCM reasonably believes that other provisions of the agreement negate those representations or otherwise make the agreement consistent with Regulation 1.56, the FCM should, by March 31, 2021, obtain a legal opinion or "well-reasoned" memorandum from outside counsel confirming that the FCM's customer agreements do not (i) guarantee the beneficial owner against loss, (ii) limit the loss of the beneficial owner, or (iii) 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.
- *Disclosure to Address Prior Representations*. To the extent that language included 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 sends a written disclosure to the beneficial owner promptly, but no later than by March 31, 2021, that: (i) states that Regulation 1.56 provides that the FCM may not represent that it will (a) guarantee the beneficial owner against loss, (b) limit the loss of the beneficial owner, or (c) 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 (ii) explains any reliance upon the operation of applicable law and severability of contractual provisions with regard to compliance with Regulation 1.56. The letter notes that this disclosure is not a substitute for mitigating legal risk regarding the agreements, as described above.

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**endnotes**

[1] CFTC Letter No. 20-28 (Sept. 15, 2020), *available at* https://www.cftc.gov/csl/20-28/download.

[2] CFTC Letter No. 19-17 (July 10, 2019), *available at* https://www.cftc.gov/csl/19-17/download.

[3] Regulation 1.56(b) provides that an FCM may not in any way represent that it will: (i) guarantee such person against loss; (ii) limit the loss of such person; or (iii) not call for or attempt to collect initial and maintenance margin as established by the rules of the applicable board of trade.

[4] Regulation 39.13(g)(8)(iii) provides that a derivatives clearing organization (DCO) must require that its clearing members ensure that their customers do not withdraw funds from their accounts with such clearing members unless the net liquidating value plus the margin deposits remaining in a customer's account after such withdrawal are sufficient to meet the customer initial margin requirements with respect to all products and swap portfolios held in such customer's account which are cleared by the DCO.

[5] *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* (Sept. 13, 2019), *available at* https://www.cftc.gov/PressRoom/SpeechesTestimony/dcrdsiodirectorstatement091319.

[6] Joint Audit Committee Regulatory Alert 19-03 (May 14, 2019), *available at* http://www.jacfutures.com/jac/jacupdates/2019/jac1903.pdf.

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