U.S. COMMODITY FUTURES TRADING COMMISSION
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Division of Swap Dealer and
Intermediary Oversight

Matthew B. Kulkin
Director

Re: No-Action Relief from the Statutory Disqualification Condition of CFTC Staff Letter No. 12-70 regarding Affiliate Support Activities of Firm "A"

Ladies and Gentlemen:

This letter is in response to your request to the Division of Swap Dealer and Intermediary Oversight ("**DSIO**" or the "**Division**") of the U.S. Commodity Futures Trading Commission ("**Commission**" or "**CFTC**") on behalf of Firm A for no-action relief such that, if Firm A engages in any Affiliate Support Activities (as defined below) on behalf of Affiliate "B" or Affiliate "C", DSIO will not recommend an enforcement action against Firm A or any of its employees for failure to register as an introducing broker ("**IB**") or commodity trading advisor ("**CTA**") as required under section 4d(g) or 4m of the Commodity Exchange Act ("**CEA**"),[1] respectively, based solely on the fact that Firm A is subject to statutory disqualification under CEA section 8a(2) or 8a(3)[2] due to certain regulatory actions described below, provided that Firm A otherwise complies with the conditions set forth in CFTC Staff Letter 12-70.[3]

I. Statutory and Regulatory Background

Section 4d(g) of the CEA provides that it is unlawful for any person to be an IB unless such person has registered with the Commission as an IB and such registration has not expired or been suspended or revoked. Section 1a(31) of the CEA,[4] as amended by the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "**Dodd-Frank**

[1] CEA section 4d(g) is codified at 7 U.S.C. § 6d(g) and CEA section 4m is codified at 7 U.S.C. § 6m.

[2] 7 U.S.C. § 12a(2) & (3).

[3] CFTC Ltr. 12-70 (Dec. 31, 2012), available at http://www.cftc.gov/ucm/groups/public/@lrlettergeneral/documents/letter/12-70.pdf.

[4] 7 U.S.C. § 1a(31).

Act"),[5] and Regulation 1.3[6] define the term, "introducing broker," to include, *inter alia*, any person who is engaged in soliciting or accepting orders for the purchase or sale of any swap, provided that such person does not accept any money, securities or property to margin, guarantee or secure any trades or contracts that result or may result therefrom.

Section 4m of the CEA provides that it shall be unlawful for any CTA, unless registered under the CEA, to make use of the mails or any means or instrumentality of interstate commerce in connection with his business as such. Section 1a(12) of the CEA,[7] as amended by the Dodd-Frank Act, and Regulation 1.3[8] define the term, "commodity trading advisor," to include, *inter alia*, any person who, for compensation or profit, engages in the business of advising others as to the value of or advisability of trading in any swap. Regulation 4.6[9] excludes from the definition of CTA a registered swap dealer ("**SD**") and its employees and principals where the commodity interest and swap advisory activities of the SD are solely incidental to the conduct of its business as an SD. Regulation 4.14[10] exempts from CTA registration a registered IB whose trading advice is solely in connection with its business as an IB.

Following implementation of the foregoing amendments to the IB and CTA definitions, the Division received various registration no-action requests from affiliates of SDs who are not registered with the Commission in any capacity ("**Agent Affiliates**").

The requests stated, in pertinent part, that SDs may deal in swaps through multiple affiliates, such that employees of an Agent Affiliate may engage in certain activities in support of an affiliated SD (an "**Affiliate SD Counterparty**") in connection with a swap transaction to be entered by an Affiliate SD Counterparty. These activities may include soliciting, negotiating, structuring, recommending, and/or accepting as agent, swap transactions on behalf of the Affiliate SD Counterparty. Agent Affiliates may receive compensation from an Affiliate SD Counterparty for services performed by their employees by way of cost and/or revenue allocation arrangements. Because the Agent Affiliates act only on behalf of Affiliate SD Counterparties that are already regulated by the Commission and not unaffiliated third-parties, the Agent Affiliates argued that IB and CTA registration was unnecessarily burdensome and requested relief from the IB and CTA registration requirements.

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[5] Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. 111-203, 124 Stat. 1376 (2010). The text of the Dodd-Frank Act may be accessed through the website of the Commission, www.cftc.gov.

[6] 17 C.F.R. § 1.3.

[7] 7 U.S.C. § 1a(12).

[8] 17 C.F.R. § 1.3.

[9] 17 C.F.R. § 4.6.

[10] 17 C.F.R. § 4.14.

In response to these requests, DSIO issued CFTC Staff Letter 12-70, stating that it would not recommend that the Commission commence an enforcement action against an Agent Affiliate or any employee thereof for failure to register as an IB or a CTA if such Agent Affiliate engages in soliciting, negotiating, structuring, recommending, and/or accepting as agent, swap transactions on behalf of an Affiliate SD Counterparty (the "**Affiliate Support Activities**"), subject to the following conditions:

- The Agent Affiliate is registered or licensed with, or subject to regulation by, a financial services, prudential, or banking regulator (including a self-regulatory organization) in specified jurisdictions (the "**Regulated Entity Condition**");

- The Agent Affiliate and the Affiliate SD Counterparty are "majority-owned affiliates" as described in Regulation 1.3;[11]

- The Agent Affiliate, the employee, and any person in the supervisory chain of command of the employee, are not subject to statutory disqualification under Sections 8a(2) and 8(a)(3) of the CEA (the "**Statutory Disqualification Condition**");

- The Agent Affiliate and the employee provide commodity interest trading advice in a manner solely incidental to the conduct of the business of the Agent Affiliate for which it is subject to regulation under the Regulated Entity Condition and are not engaged in any activity other than the Affiliate Support Activities that would require registration as an IB, CTA or associated person ("**AP**") thereof;

- The Agent Affiliate and the Affiliate SD Counterparty execute in writing an undertaking by which they each agree to be jointly and severally liable for any violation of the CEA or Commission Regulations by any employee of the Agent Affiliate engaged in any Affiliate Support Activity on behalf of the Affiliate SD Counterparty, and the Agent Affiliate consents to the jurisdiction of the Commission to investigate and take enforcement action against the Agent Affiliate or any employee thereof engaged in any Affiliate Support Activity on behalf of the Affiliate SD Counterparty for any violation of the CEA or Commission Regulations by such employee (the "**Joint Liability Undertaking**"); and

- The Affiliated SD Counterparty maintains the Joint Liability Undertaking at its main business office and in accordance with Regulation 1.31.[12]

II. Firm A's Requests

Firm A represents that it wishes to rely on CFTC Letter No. 12-70 to engage in Affiliate Support Activities on behalf of Affiliate B and Affiliate C (together, the "**Affiliated**

[11] 17 C.F.R. § 1.3.

[12] 17 C.F.R. § 1.31.

SDs"), each of which has been provisionally registered with the Commission as SDs since [ ]. All the relevant swaps would be executed in the name of, and booked at, one of the Affiliated SDs. Firm A will not accept any money, securities or other property from swap counterparties or the Affiliated SDs in connection with such swap transactions to margin, guarantee or secure the obligations of any such counterparty or the Affiliated SDs under any of the swap transactions. While all of Firm A's employees engaged in Affiliate Support Activities on behalf of the Affiliated SDs will be located in Foreign Jurisdiction "Z", the counterparties to certain of the swaps entered into by the Affiliated SDs and intermediated by Firm A would be located in the United States.

Firm A is a broker-dealer incorporated in Foreign Jurisdiction Z and regulated by Foreign Regulator "Y" and is not registered with the Commission in any capacity. Firm A and the Affiliated SDs are wholly-owned subsidiaries of Group D, a banking and financial services company formed under the laws of the United States (i.e., Firm A and the Affiliated SDs are "majority-owned affiliates" as described in Regulation 1.3).

On XX, Foreign Regulator Y issued a[n] order (the "**2019 Y Order**"), finding that Firm A violated the supervision requirements of Foreign Statute "X" because it failed to establish and maintain a sufficient trading control system to prevent unfair trades in connection with Foreign Jurisdiction Z government bond futures, including certain spoofing activity by a former employee of Affiliate C in connection with certain Foreign Jurisdiction Z government bond futures listed on the "W" Exchange.[13] In this regard, it is important to note that the spoofing activity occurred at an affiliate of Firm A in Foreign Jurisdiction "U", and was not the activity of an employee of Firm A in Foreign Jurisdiction Z.

Because Foreign Statute X is similar to the CEA, the Securities Act of 1933, and the Securities Exchange Act of 1934, the findings in the 2019 Y Order constitute grounds for a statutory disqualification under Section 8a(3)(B) of the CEA.[14] As a result, following the issuance of the 2019 Y Order, Firm A would no longer be able to engage in Affiliate Support Activities on behalf of Affiliated SDs in reliance on CFTC Letter No. 12-70 due to failure to meet the Statutory Disqualification Condition.[15]

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[13] As a result of this former Affiliate C employee's actions, Foreign Regulator Y ordered Affiliate C to pay an administrative monetary penalty.

[14] Section 8a(3)(B) of the CEA provides that grounds for statutory disqualification exist if a person has been found by a governmental body to have violated a statute of a foreign jurisdiction that is similar to the Securities Act of 1933 or the Securities Exchange Act of 1934, or any rule, regulation, or order under any such statute.

[15] On [ ], the Division granted Firm A no-action relief similar to the relief provided in this letter following the entering of [a] Commission Order [ ], which found that that Firm A violated certain provisions of the CEA and imposed remedial sanctions on Firm A, and Foreign Regulator Y entering two administrative orders against Firm A in [ ] (together with the 2019 Y Order, the "Foreign Regulator Y Orders"). The Division conditioned such relief on Firm A otherwise complying with the conditions set forth in CFTC Letter No. 12-70 as well as additional conditions enumerated in the

A. Mitigating Circumstances Related to the 2019 Y Order

Firm A is aware that, in connection with an application to register an IB or CTA, the Commission (or the National Futures Association ("**NFA**"), as its delegatee) may exercise discretion to allow a person who would otherwise be statutorily disqualified under Section 8a(2) or 8a(3) of the CEA to register with the Commission notwithstanding such statutory disqualification. Firm A believes that it would be appropriate for the Division to exercise similar discretion in the instant context by providing relief from the statutory disqualification condition of CFTC Letter No. 12-70 subject to certain conditions. Firm A further notes that the Division adopted a similar approach with respect to associated persons of a swap dealer, who likewise are not subject to registration with the Commission but may be barred from conducting Commission-regulated business as a result of a statutory disqualification.[16]

Firm A believes that there are several mitigating circumstances with respect to the 2019 Y Order that support granting the requested relief.[17] First, Firm A notes that the violation identified in the 2019 Y Order relates solely to deficiencies in Firm A's existing policies, procedures, systems, and controls, not fraud, manipulation or other intentional misconduct.

Second, Firm A states that although the 2019 Y Order is connected to misconduct by an employee of an affiliate of Firm A, namely, Affiliate C, that individual is no longer employed by Affiliate C and no other employees have been found to have engaged in misconduct. Thus, no individual who engaged in the spoofing activity is or will be an employee of Firm A or engaged in Affiliate Support Activities covered by CFTC Letter No. 12-70.

Third, Firm A indicates that system features developed by the vendor who provided Firm A's trade surveillance system resulted in the system not capturing trading activity that took place after Friday evening and over the weekend, which contributed to Firm A's failure to detect spoofing activity.[18] Firm A employees were not aware of the system deficiency until the investigation corresponding to the 2019 Y Order occurred. Firm A has since learned that other firms who used the same trade surveillance system had the same deficiency in their own systems.

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no-action letter, including a duty to promptly notify Division staff of an event which could constitute a statutory disqualification under Section 8a(2) or 8a(3) of the CEA and, in the event of such disqualification, to cease to rely on the [ ] relief.

[16] See CFTC Letter No. 12-15 (Oct. 11, 2012).

[17] DSIO consulted with Foreign Regulator Y with respect to the 2019 Y Order and the issuance of this letter.

[18] With respect to detecting the spoofing activity, DSIO notes that such activity occurred over a very short period from 7:45 PM on [XX] to 1:11 AM on [XX+1] and 7:16 PM on [YY] to 1:02 AM on [YY+1].

Fourth, Firm A notes that the 2019 Y Order is related to futures activities and does not relate to swaps activities conducted by Firm A on behalf of the Affiliated SDs or otherwise. Finally, Firm A states that it is improving, and will continue to strengthen, its efforts to comply with the applicable Foreign Jurisdiction Z laws and regulations.

Lastly, the 2019 Y Order requires Firm A to take the following remedial actions (the "**Foreign Regulator Y Remedial Actions**"):

(1) Clarify management's stance with respect to compliance and appropriate business operations, foster company-wide awareness of legal compliance and sound corporate culture, and enhance and strengthen the management control environment and internal control systems;

(2) Prepare and establish an improvement plan based on the 2019 Y Order's findings, including measures for preventing recurrence of the misconduct underlying the 2019 Y Order;

(3) Verify the effectiveness of the measures taken pursuant to the business improvement plan, and, if such measures are found to be inadequate, take additional measures; and

(4) With regard to (1) through (3) above, provide Foreign Regulator Y quarterly written reports regarding implementation of such remedial measures.

In sum, Firm A believes that the lack of intentional misconduct, together with the Foreign Regulator Y Remedial Actions, mitigate the regulatory concerns underlying the Statutory Disqualification Condition because they minimize the extent to which Firm A's past violations are indicative of how it will behave in the future. Firm A has represented that it is committed to continuing to conduct its business in full compliance with all applicable regulatory obligations.

III. Staff Position

Given the Commission Order and the Foreign Regulator Y Orders, Firm A could not qualify for the relief under CFTC Staff Letter 12-70 due to the statutory disqualification condition therein. Notwithstanding that disqualification, the Division believes that a time-limited no-action position is warranted in light of the reasons articulated by Firm A above. Accordingly, until June 30, 2020, the Division will not recommend that the Commission commence an enforcement action against Firm A or any employee of Firm A for failure to register as an IB or CTA if Firm A or an employee of Firm A engages in Affiliate Support Activities (as defined in CFTC Staff Letter 12-70) on behalf of the Affiliated SDs, and complies with the following conditions:[19]

[19] Conditions (1) through (5) mirror the ones in Part III of CFTC Staff Letter 12-70.

(1) Firm A is registered or licensed with, or subject to regulation by, Foreign Regulator Y;

(2) Firm A and the Affiliated SDs are "majority-owned affiliates" as described in Regulation 1.3;[20]

(3) Neither Firm A nor its employees engaged in Affiliate Support Activities on behalf of the Affiliated SDs are subject to a statutory disqualification under Section 8a(2) or (3) of the CEA, and no person in the supervisory chain of command of those relevant employees is subject to such a statutory disqualification, other than solely as a result of the Commission Order or the Foreign Regulator Y Orders;

(4) Neither Firm A nor its employees are otherwise engaged in activity that would require registration as IBs, CTAs or APs thereof;

(5) Firm A and each of the Affiliated SDs execute in writing an undertaking by which they each agree to be jointly and severally liable for any violation of the CEA or Commission Regulations by any employee of Firm A engaged in any Affiliate Support Activity on behalf of an Affiliated SD; Firm A consents to the jurisdiction of the Commission to investigate and take enforcement action against Firm A or any employee of Firm A engaged in any Affiliate Support Activity on behalf of an Affiliated SD for any violation of the CEA or Commission Regulations by such employee; and the Affiliated SDs maintain such undertakings at their main business offices and in accordance with Regulation 1.31;[21]

(6) Firm A develops, implements, and follows policies and procedures reasonably designed to monitor for and detect circumstances or events, including foreign regulatory actions, that might constitute a statutory disqualification of Firm A under Section 8a(2) or (3) of the CEA;

(7) Such circumstances or events are promptly escalated to appropriate personnel for a determination of whether such circumstance or event constitute a statutory disqualification under Section 8a(2) or (3) of the CEA; and

(8) If it is determined that Firm A is subject to a statutory disqualification under Section 8a(2) or (3) of the CEA, other than solely as a result of the Commission Order or the Foreign Regulator Y Orders, Firm A will promptly notify Division staff and cease to rely on this letter.

Failure to comply with any of the conditions of this letter, the undertakings of the Commission Order, or the Foreign Regulator Y Remedial Actions will automatically terminate the relief granted herein. The Division further wants to emphasize that this no-action position with respect to the Statutory Disqualification Condition only applies to Firm A and its employees in connection with the specific facts and circumstances outlined in this letter. The Division is not, with this letter, granting any other person relief concerning the statutory or regulatory provisions governing persons who are subject to statutory disqualification.

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[20] 17 C.F.R. § 1.3.

[21] 17 C.F.R. § 1.31.

This letter, and the positions taken herein, represent the view of the Division only, and do not necessarily represent the position or view of the Commission or of any other office or division of the Commission. The relief issued by this letter does not excuse Firm A or its employees from compliance with any other applicable requirements contained in the CEA or in the Commission Regulations issued thereunder. For example, Firm A remains subject to all antifraud provisions of the CEA.[22] Further, this letter, and the relief contained herein, is based upon the representations made to the Division. Any different, changed or omitted material facts or circumstances might render this letter void.

Should you have any questions, please contact me at (202) 418-5326, Frank Fisanich, Chief Counsel, at (202) 418-5949, or Gregory Scopino, Special Counsel, at (202) 418-5175.

Very truly yours,

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Cc: Regina Thoele, Compliance
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[22] *See, e.g.*, sections 4b and 4*o* of the CEA. 7 U.S.C. §§ 6b & 6o.