SWAPS PROFICIENCY REQUIREMENTS FOR ASSOCIATED PERSONS; REVISED FORM 7-R

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Investment Management Alert

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Introduction

By a Notice to Members dated March 25, 2019, the National Futures Association ("NFA"), the self-regulatory organization for the U.S. derivatives industry, announced that it had amended rules and adopted an interpretive notice that will require associated persons of swap firms ("Swap APs") to complete new mandatory swaps training and testing (the "Proficiency Requirements").[1] The Proficiency Requirements mandate that Swap APs of commodity pool operators ("CPOs") and commodity trading advisors ("CTAs") meet a new minimum proficiency standard, which tests both their market knowledge and their knowledge of regulatory requirements related to swaps. The Proficiency Requirements will be effective on January 31, 2020, with a compliance deadline for existing registrants of January 31, 2021.

Swap firms include CPOs that operate pools that engage in swap transactions and CTAs that advise clients regarding such transactions. Swap APs are individuals who solicit investors in such pools or clients to open discretionary accounts that may engage in swap transactions, as well as the supervisors of such persons.

The Proficiency Requirements will be administered via the Internet and consist of both a training and a testing component. For Swap APs at a CPO or CTA, the training will take approximately four hours to complete and will consist of the following modules:

1. swaps products and applications;
2. regulation of the swaps market;
3. supervision and intermediary compliance; and
4. anti-fraud and other regulatory requirements.[2]

Swaps Proficiency Requirements Compliance Deadline

All individuals who are approved as Swap APs at a CPO or CTA must satisfy the new NFA Proficiency Requirements by January 31, 2021, to remain approved as a Swap AP. There is no grandfathering of persons already registered. In addition, under the new requirements individuals applying for approval to become Swap APs of a CPO or CTA after that date must have either: passed the swaps Proficiency Requirements within two years before the date of the application, or passed the swaps Proficiency Requirements and not had a period of greater than two consecutive years in which they have not been approved as a Swap AP. The requirements will apply to all Swap APs, even if a firm engages another entity such as a securities broker-dealer to handle solicitation activities.

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Reporting and Recordkeeping Requirements

There are no specific reporting or recordkeeping requirements for CPOs and CTAs and their Swap APs associated with the Proficiency Requirements, as the NFA should be able to track compliance with the Proficiency Requirements through its own systems. Nevertheless, CPOs and CTAs may wish to consider establishing their own method to track compliance with the Proficiency Requirements for their Swap APs in case a question arises. Swap APs also should retain the certificate of completion that they will receive, as that may be useful if the person needs to prove completion within a certain time period.[3]

CFTC Revises Registration Form 7-R

On March 11, 2019, the Commodity Futures Trading Commission ("CFTC") published its revised Form 7-R, the application form that firms must use to register under the Commodity Exchange Act ("CEA") as a CPO or CTA.[4] The CFTC modified Form 7-R upon request from NFA and the new Form 7-R will be implemented when the NFA makes it available on its website. When implemented, the revised Form 7-R will be applicable to new registrants only, and existing registrants will not need to re-submit or update the form unless otherwise required.

Among other modifications, the revised Form 7-R requires applicants to provide additional information regarding non-natural person principals of the applicant and disciplinary matters. In the section titled "Holding Company Information," the revised Form 7-R requires that, for each entity that is a principal of the applicant, the applicant must provide the entity's Federal Employer Identification Number (if it has one) and the location where it is incorporated, organized, or established to help ensure accurate identification of the entity. In the section titled "Disciplinary Information — Regulatory Disclosures," a new provision was added to Question E that directs the applicant to disclose whether it has ever been found to have "failed to supervise another person's activities under any investment-related statute or regulation." Question E already requires applicants to disclose whether they have violated, or aided and abetted the violation of, any investment-related statutes or regulations, and the new question is intended to ensure complete disclosure of conduct that may result in a refusal or limitation on registration.

In addition, the CFTC simplified Form 7-R by removing questions pertaining solely to NFA membership. Previously, Form 7-R functioned both as a registration form and as an application for NFA membership. The NFA will now require the completion of a separate application for NFA membership.

Conclusion

The adoption of the long-awaited Proficiency Requirements for Swap APs should not be surprising to the Swap APs or their sponsors. Helpfully, the new requirements provide for an implementation period of over a year for existing registrants and the mechanics of satisfying the Proficiency Requirements should be simpler than sitting for the Series 3 examination. The revised Form 7-R should have no impact upon existing registrants and will be more suited to an electronic environment with hyperlinks to applicable provisions of the CEA, CFTC regulations, and NFA rules, and a simplified process for supplying supplemental information through a "Disclosure Matter Page" system.

Notes:

[1] The Notice to Members, Notice I-19-09, is available here and describes in greater detail the Proficiency Requirements and implementation timeline.

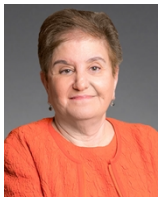
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[2] The Proficiency Requirements also mandate that individuals acting as Swap APs of futures commission merchants and introducing brokers complete this “Short Track” regimen. In addition, individuals acting as Swap APs of swap dealers (“SDs”) must satisfy a more extensive “long track” proficiency requirement, which consists of eight modules and takes twice as long to complete.

[3] SDs will be required to maintain records that their Swap APs have satisfied the Proficiency Requirements and to provide those records to NFA during an examination or otherwise upon request. Adequate documentation would include a log identifying individuals and dates of completion or copies of the certificate of completion that the individual Swap AP receives.

[4] 84 Fed. Reg. 8671 (March 11, 2019), which is available by clicking here.

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