

# CLIENT UPDATE

## RELIEF FROM REGULATION 23.22(B) IN RESPECT OF CERTAIN ASSOCIATED PERSONS

### NEW YORK

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On December 7, 2012, the Commodity Futures Trading Commission (the “CFTC”) granted limited no-action relief to swap dealers (“SDs”) and major swap participants (“MSPs” and, together with SDs, “Swap Entities”) from compliance with the prohibition in Regulation 23.22(b) against permitting any statutorily disqualified person to effect swaps on their behalf. The no-action relief applies to (1) non-U.S. associated persons (“APs”) of a Swap Entity who deal only with non-U.S. swap counterparties and (2) persons employed by a Swap Entity in a clerical or ministerial capacity.

### BACKGROUND AND REQUEST FOR RELIEF

Section 4s(b)(6)<sup>1</sup> of the Commodity Exchange Act (the “CEA”) prohibits Swap Entities from permitting any person associated with such Swap Entity who is subject to statutory disqualification to effect or be involved in effecting swaps on its behalf if the Swap Entity knows or, in the exercise of reasonable care, should know of such disqualification.

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<sup>1</sup> Unless otherwise stated, all Section references are to sections of the Commodity Exchange Act.

Section 1a(4) defines “associated person” of a Swap Entity as a person associated with a Swap Entity as a partner, officer, employee or agent (or any person occupying a similar status or performing similar functions), in any capacity involving (1) the solicitation or acceptance of swaps or (2) the supervision of any person(s) so engaged. Section 1a(4) excludes from this definition, other than for purposes of Section 4s(b)(6), any person associated with a Swap Entity “the functions of which are solely clerical or ministerial.”

While APs of a Swap Entity are not required to register with the CFTC, Regulation 23.22 prohibits certain persons from serving in such a capacity. Specifically, Regulation 23.22(b) provides that no Swap Entity may permit a “person” who is subject to statutory disqualification under Section 8a(2) or 8a(3) to effect or be involved in effecting swaps on its behalf if the Swap Entity knows or, in the exercise of reasonable care, should know of the disqualification (the “Prohibition”). Regulation 23.22(a) provides that, for these purposes, the term “person” means an “associated person” of a Swap Entity, as defined in Section 1a(4) and Regulation 1.3(aa)(6).

#### *Non-U.S. APs Dealing Only with Non-U.S. Counterparties of Swap Entities*

Regulation 23.22(b) provides an exception from the Prohibition with respect to any person listed as a principal or registered as an AP of, among other entities, a futures commission merchant (“FCM”) or a commodity pool operator (“CPO”), notwithstanding that such person is statutorily disqualified from registration under section 8a(2) or 8a(3). As the CFTC notes in the no-action letter, absent this exception, a person could be permitted to direct futures-related activities or solicit futures-related business with members of the retail public as a principal or AP of a FCM or CPO, but could nonetheless be barred from soliciting, accepting, or otherwise being involved in effecting swaps with “significantly more sophisticated clients” as an AP of a Swap Entity.

While Section 4k and Regulation 3.12 generally require the registration of all APs who are associated with registrants that are not Swap Entities, Regulation 3.12(h)(1)(iv) provides an exception from this requirement for a person who engages in activity as an AP “from a location outside the United States, its territories or possessions, and limits such activities to customers located outside the United States, its territories or possessions” (the “Non-U.S. Exception”). Therefore, an AP who is subject to statutory disqualification under Section 8a(2) or 8a(3) is not prohibited from soliciting or accepting commodity futures or option accounts from customers located outside the United States. The purpose of the Non-U.S. Exception is to focus the CFTC’s limited customer protection resources on domestic firms and firms soliciting or accepting orders from domestic users of the futures markets.

However, because APs of Swap Entities are not required to register with the CFTC, the Non-U.S. Exception is inapplicable to the Prohibition. Therefore, absent any relief, a Swap Entity would be subject to the Prohibition even with respect to an AP who engages in activity from outside the United States and limits such activity to counterparties located outside the United States. Citing the purpose of the Non-U.S. Exception set forth above, the National Futures Association (the “NFA”) recommended that relief from the Prohibition equivalent to that available for all other APs under Regulation 3.12(h)(1)(iv) be available to Swap Entities with respect to their APs.

### *Persons Employed in a Clerical or Ministerial Capacity*

Regulation 1.3(aa)(6) defines “associated person” of a Swap Entity in essentially the same manner as such term is defined in Section 1a(4) and also excludes persons employed in a clerical or ministerial capacity. In the no-action letter, the CFTC notes that this exclusion (the “Clerical Exclusion”) is consistent with the definition (and exclusion for clerical or ministerial activity) in the other provisions of Regulation 1.3(aa) defining the term “associated person” in the context of other CFTC registrants.

The NFA recommended that, because Regulation 23.22, by its terms, applies to an AP of a Swap Entity as defined in Section 1a(4) and Regulation 1.3(aa), and because Section 1a(4) and Regulation 1.3(aa)(6) each contain a Clerical Exclusion which should be read in conjunction with Section 4s(b)(6), relief from the Prohibition should be provided to Swap Entities with respect to persons who are employed in a clerical or ministerial capacity.

### **NO-ACTION RELIEF**

The no-action letter provides that the Division of Swap Dealer and Intermediary Oversight of the CFTC will not recommend that the CFTC commence an enforcement action against any Swap Entity for failure to comply with Regulation 23.22(b) if the Swap Entity:

- employs as an AP or otherwise permits a person to effect or be involved in effecting swaps on its behalf where, in either case, the person may be subject to a statutory disqualification under Section 8a(2) or 8a(3), *provided* such person is engaged in such activity from a location outside the United States, its territories or possessions and limits such activities to counterparties located outside the United States, its territories or possessions;<sup>2</sup> or

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<sup>2</sup> The CFTC notes in the no-action letter that extending the Non-U.S. Exception to Swap Entities is reasonable since it will align the treatment of each person who comes within the AP definition regardless of whether such person is subject to a registration requirement.

- employs in a clerical or ministerial capacity a person who may be subject to a statutory disqualification under Section 8a(2) or 8a(3).

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Please do not hesitate to contact us with any questions.

December 21, 2012