

CFTC Establishes Registration Process for Swap Dealers; Key Registration Requirements To Be Set Later

Selected NFA Form 7-R Requirements for Swap Entities

- Organizational information
- Location of business records
- Branch office locations
- Non-U.S. regulators
- Criminal, regulatory and disciplinary history and certain litigation and bankruptcy-related financial disclosures
- Contact information for individuals in charge of registration, membership, accounting and compliance
- An agreement to provide extensive information to the NFA upon request, cooperate with investigations and comply with NFA rules
- For foreign applicants, an agreement to produce books and records in the U.S. for inspection by the CFTC, NFA and DOJ on 72-hours' notice, and to provide to the NFA copies of reports from or notices to non-U.S. regulators, as well as submission to jurisdiction and certification as to certain foreign law matters

The CFTC issued a final rule on January 11, 2012 that specifies the registration process for swap dealers and major swap participants ("**swap entities**"). On the same day, the CFTC also issued an order delegating to the National Futures Association ("**NFA**") responsibility for administering swap entity registration.

Consistent with its prior swap entity registration proposal, the CFTC adopted a provisional registration process whereby swap entities must provisionally register with the CFTC by the latest effective date of the rules defining "swap," "swap dealer" and "major swap participant" ("**swap definitional rules**"), which have not yet been established.¹ Provisional registrants will need to demonstrate, in a manner that has not yet been prescribed by the CFTC, compliance with swap entity requirements as the final rules concerning those requirements are adopted by the CFTC. Because some swap entity regulations are unlikely to be final by the registration deadline, swap entities must provisionally register without knowing what they will need to do in order to become permanently registered or the full extent of requirements to which they will be subject as registrants.

Swap Entity Registration Process

Registration Forms

The registration process for swap entities draws on the existing registration scheme in place for other CFTC registrants, such as futures commission merchants. To apply for registration as a swap entity and become a member of the NFA, an applicant must submit to the NFA online a Form 7-R, selected requirements of which are listed in the sidebar.²

Applicants must also submit to the NFA any documentation that may be required to demonstrate compliance and ability to comply with specified regulations (as listed in the sidebar on page 2) for swap entities set forth in section 4s of the Commodity Exchange Act ("**section 4s regulations**") that

¹ According to the CFTC's [schedule](#) of expected rulemaking, this rule will be finalized by April 2012.

² The current version of Form 7-R is available [here](#). The current version of Form 8-R is available [here](#). Note that these forms will presumably be updated by the NFA to refer to swap entities.

Section 4s Regulations

- Capital and margin
- Reporting and recordkeeping
- Daily trading records
- Business conduct standards
- Documentation standards
- Duties (e.g., conflicts of interest, risk management, portfolio reconciliation and compression)
- Chief compliance officer
- Segregation of customer funds for uncleared swaps

Selected NFA Form 8-R Requirements for Swap Entity Principals

- Personal identifying information
- Criminal, regulatory and employment disciplinary information and certain litigation and bankruptcy-related financial disclosures
- Employment and education history
- Residential history
- Acknowledgement that the principal must update the business address provided while registered and for two years after termination of registration
- Agreement and certification by the principal's "sponsor" firm concerning pre-employment verification, supervision and other matters
- Principal's authorization for the NFA to conduct an investigation to determine the principal's fitness for registration, which may include contacting foreign regulatory and law enforcement authorities
- Principal's agreement to furnish and update information and agreement to abide by applicable rules

are in effect at the time of application. The specific documentation that is required to demonstrate compliance is not discussed in the rule, and will instead be considered in connection with the adoption of each section 4s regulation. Swap entities may seek confidential treatment of documentation submitted to demonstrate compliance with the section 4s regulations.

An applicant must also submit to the NFA a Form 8-R (selected requirements of which are described in the sidebar) on behalf of each of its principals, along with a fingerprint card. Any principal who is an outside director and is not also an officer or employee of the entity may, in lieu of a fingerprint card, submit to the NFA a certification that he or she does not engage in certain solicitation activities, regularly have access to customer funds, or directly supervise persons engaged in such activities.

Registered swap entities and their principals must "promptly" correct any deficiency or inaccuracy in Form 7-R or Form 8-R that renders the forms inaccurate or outdated. In addition, the NFA will establish a date for swap entities to review and update, on an annual basis, any registration information submitted to the NFA.

Provisional Registration

Under the provisional registration process, an applicant will become "provisionally registered" upon filing Form 7-R and any documentation required under the section 4s regulations. Once the NFA notifies the applicant that it is provisionally registered, the NFA will determine whether the documentation submitted demonstrates compliance with the section 4s regulations that are in effect at that time. Subsequently, the NFA will either issue a notice of initial compliance or notify the applicant that its application is deficient.

To the extent that a section 4s regulation is not final at the time of an applicant's provisional registration, the applicant must supplement the initial documentation provided to the NFA to demonstrate compliance with the section 4s regulation as it becomes final. Therefore, a provisional registrant must consult each section 4s regulation to determine precisely when compliance is required, what is required to comply and what additional materials must be submitted to the NFA to demonstrate compliance. A provisional registrant will become fully registered after the NFA confirms that the registrant has demonstrated initial compliance with all of the section 4s regulations and all other applicable registration requirements.

Withdrawal of Provisional Registration

An applicant that fails to demonstrate compliance with a section 4s regulation will be notified by the NFA that its application is deficient and must either withdraw its application or cure the deficiency within 90 days of the receipt of notification of deficiency. The CFTC may in its discretion extend the 90-day cure period upon written request. The rule does not specify a process for confirming that the deficiency has been cured. If, however, any deficiency is not cured within the time period prescribed, the application will be deemed withdrawn.

**Selected General Requirements
Applicable to All NFA Members**

- Preparation for periodic, announced on-site NFA audits
- Anti-money laundering program
- Business continuity and disaster recovery plan
- Restrictions on doing business with non-members who are required to be registered with the CFTC
- Financial requirements
- Requirements for sales practices and promotional material
- Supervision
- Completion of annual registration updates

Effect of Withdrawal, Cessation or Revocation of Registration

A swap entity is prohibited from engaging in new activities requiring registration as a swap entity during the pendency of any suspension of any registration, or upon withdrawal or revocation of registration. Unless specifically reserved in the applicable swap documentation, no withdrawal, cessation or revocation of swap entity registration will affect any existing swap.³

Oversight of Swap Entities by the NFA

Once swap entities become NFA members, they presumably will be subject to the NFA's general requirements for all members, selected elements of which are enumerated in the sidebar. Also, the release notes that the CFTC expects the NFA to adopt rules for swap entities that are at least as stringent as the section 4s regulations and that the NFA will engage in active oversight of swap entities to monitor and ensure compliance with those rules. The CFTC has authority to review the performance of the functions that it has delegated to the NFA and to approve any change in or addition to the NFA's rules. To the extent that a section 4s regulation is not specific regarding the criteria for, and manner of, determining that an applicant has demonstrated its initial compliance with the regulation, the CFTC anticipates providing written guidance to the NFA.

The CFTC maintains authority to conduct on-site examinations of swap entities and adopt and enforce regulations applicable to swap entities.

Associated Person Requirements

Associated persons of swap entities who are not principals are not required to register with the CFTC. However, a swap entity is prohibited from permitting a person associated with it who is subject to a "statutory disqualification" under sections 8a(2) and (3) of the Commodity Exchange Act to effect or to be involved in effecting swaps on the swap entity's behalf, if the swap entity "knew, or in the exercise of reasonable care should have known, of the statutory disqualification." The rule is unclear regarding what level of diligence is required to satisfy this standard, or whether there will be a waiver process for minor statutory disqualifications. Although a swap entity is permitted to use the services of a third party, including the NFA, to perform background checks and obtain information as to whether a

³ Swap counterparties may want to consider including a provision to this effect in their swap documentation.

Examples of Grounds for Statutory Disqualification

- A permanent or temporary injunction from commodities or securities practices
- A felony conviction within the past ten years, that involved, for example, futures or securities advice, fraud or theft or arose out of the conduct of the business of a registered entity
- A finding by the CFTC or other governmental body of a violation of commodities or securities law in the past ten years
- An outstanding CFTC order denying privileges or revoking membership to any registered entity
- A finding of a failure to supervise, where the person subject to supervision committed a violation of commodities or securities laws
- Willfully making a materially false or misleading statement or omitting any material fact in a CFTC filing or report

prospective associated person is subject to a statutory disqualification, the use of a third-party service provider would not provide a safe harbor for the firm if an associated person is in fact subject to a statutory disqualification.

The final rule, unlike the proposed rule, contains an exception from the prohibition for any person who is listed as a principal or registered as an associated person of another CFTC registrant, even though such person may be subject to a statutory disqualification.

The final rule limits the definition of “associated person” to natural persons, eliminating concerns of swap entities that are part of large corporate groups that may have legal entity affiliates that are subject to a statutory disqualification.

Extraterritoriality

Although the CFTC’s proposed registration rule had requested comment on the extraterritorial application of the swap entity registration requirements, the CFTC specifically declined to address this critical issue in the final rule. According to the CFTC’s schedule of expected rulemaking, extraterritorial issues will be discussed in a separate proposal that will be released sometime after March 2012. This leaves many internationally active swap entities in a state of uncertainty regarding the implications of swap entity registration for their global operations.

Security-Based Swap Entity Registration

Entities that meet the definitions of swap entity and security-based swap entity (“**SBS entity**”) must register separately with the CFTC and the SEC, respectively.⁴ In an attempt to avoid unnecessary duplication, the SEC’s recently proposed SBS entity registration rule would permit an SBS entity that is registered or in the process of registering with the CFTC as a swap entity to submit a somewhat streamlined application form to the SEC.

Timing of Swap Entity Registration

Swap entities presumably may begin to provisionally register with the CFTC once the final rule becomes effective, that is, 60 days after the final rule is published in the *Federal Register*. A swap entity will be considered provisionally registered upon filing of the application and providing any documentation required under the applicable section 4s regulations – and not upon the NFA’s review and approval of the documentation.

⁴ The SEC [proposed](#) a registration process for SBS entities on October 12, 2011.

If you have any questions regarding the matters covered in this publication, please contact any of the lawyers listed below or your regular Davis Polk contact.

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Swap entities must be provisionally registered by the effective date of the swap definitional rules, or cease conducting any activity as a swap entity. According to the CFTC's schedule of expected rulemaking, these rules will be final by the end of March 2012 and likely will be effective 60 days after publication in the *Federal Register*. Therefore, the deadline for provisional registration could be sometime between the end of March and the end of May 2012.

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