WILLKIE FARR & GALLAGHER LLP

CLIENT ALERT

CFTC Enforcement Action Highlights Expansion of Exchange Registration Requirement

October 3, 2022

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On September 26, 2022, the Commodity Futures Trading Commission ("**CFTC**") issued an order settling charges against Asset Risk Management, LLC ("**ARM**"), a registered Commodity Trading Advisor ("**CTA**") specializing in advising oil and natural gas producers, for operating an unregistered swap execution facility ("**SEF**").[1] For approximately five years, starting in September 2017, the CFTC alleged that ARM provided its clients with the ability to execute swaps by accepting bids and offers made by multiple participants on a trading system or platform in various swap tenors. The order requires ARM to cease and desist from continuing to operate as an unregistered SEF and has instituted a $200,000 civil monetary penalty against the firm. ARM neither admitted nor denied the facts and conclusions in the CFTC's order. The ARM order serves as another example that persons that intermediate swaps, but that are not currently registered as SEFs, should evaluate (or re-evaluate) whether they meet the SEF definition and thereby would need to register with the CFTC.

The CFTC published this order almost a year after the CFTC Division of Market Oversight ("**DMO**") issued an advisory and a similar enforcement action settling charges against Symphony Communication Services, LLC for failing to register as a SEF. Willkie's client alert summarizing the DMO Advisory is available here.

ARM's CTA services included assisting its clients in mitigating commodity price risks in the energy distribution, transportation, and commercial industries. As part of those services, ARM would often recommend that clients execute various types of swap transactions. The CFTC explained that ARM also provided customers with a list of potential swap

[1] *In the Matter of Asset Risk Management, LLC*, CFTC Docket No. 22-36 (Sept. 26, 2022), available here.

counterparties with whom ARM had a relationship and ARM introduced customers to counterparties to enter into swap relationship documentation such as an ISDA master agreement.

The swap transaction flow for ARM customers typically involved the following steps:

- ARM would receive a request for swap pricing from a customer and then would send a pricing request (and sometimes other terms) to one specified counterparty or a set of counterparties with whom the relevant client had in place an ISDA agreement.

- After a potential swap counterparty responded to ARM, if ARM had the authority to execute the swap on behalf of the customer, it would approve or reject the counterparty's response. If ARM did not have the authority, it would arrange a phone call between the customer and counterparty in order to agree to the terms.

ARM facilitated swap transactions for approximately 70 clients and worked with 20 to 30 swap counterparties. The CFTC found that this business model satisfied the definition of a SEF and ARM's operations thereby violated of the Commodity Exchange Act ("**CEA**") and the CFTC's regulations over several years.[2]

CEA section 1a(50) defines a SEF as any person that operates "a trading system or platform in which multiple participants have the ability to execute or trade swaps by accepting bids and offers made by multiple participants in the facility or system, through any means of interstate commerce, including any trading facility, that—(A) facilitates the execution of swaps between persons; and (B) is not a designated contract market." Similar to the DMO Advisory and the Symphony order last year, the CFTC re-emphasized that any person operating a trading system or platform may be required to register as a SEF if it provides multiple participants with the "'*ability* to execute or trade swaps' with multiple participants" (so-called "multiple-to-multiple" connectivity).

The CFTC has made clear that it interprets the multiple-to-multiple prong of the SEF definition to include a request for quote ("**RFQ**") system "where a single requestor initiates for each transaction a one-to-many communication by submitting an RFQ to multiple participants."[3] According to the CFTC, such an RFQ model provides multiple participants with the "'*ability* to execute or trade swaps' with multiple participants."[4] By contrast, "a one-to-many system or platform on which the sponsoring entity is the counterparty to all swap contracts executed through the system or platform" does not meet the multiple-to-multiple prong of the SEF definition. As we have mentioned in previous alerts, the CFTC has separately

[2] CEA Section 1a(50). All entities that meet the definition of a SEF must register with the CFTC. CEA section 5h(a)(1) establishes the SEF registration requirement, providing that no person may operate a facility for the trading or processing of swaps unless the facility is registered as a SEF or as a designated contract market. *See* 7 U.S.C. § 7b–3(a)(1).

[3] ARM Order at 3.

[4] *Id*.

suggested that swaps intermediaries would not need to register as SEFs if the swaps at issue are sent to a SEF for execution.

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