

NFA Update

New proficiency requirements for hedge fund managers

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The National Futures Association, the self-regulatory organization for the commodity futures and swaps industry, recently updated its rules¹ to impose “swaps proficiency requirements” on associated persons of NFA members that engage in swaps-related activities. These requirements are likely to be applicable to a significant number of hedge fund advisers (i.e., advisers that are, or are required to be, registered with the Commodity Futures Trading Commission and to be NFA members). While most private equity sponsors are not likely to fall within the scope of any NFA licensing requirement, they should take this opportunity to confirm that the basis for any exemption remains valid.

Effective dates

Compliance with the new NFA swaps proficiency requirements will be required as of Jan. 31, 2021, and online access to the new training modules is targeted for Jan. 31, 2020.

Fees

A fee schedule for completing the swaps proficiency requirements has not yet been published.

Covered individuals

The new swaps proficiency requirements will apply to associated persons of all managers registered with the NFA as commodity pool operators (“CPOs”) or commodity trading advisors (“CTAs”) that engage in activities involving swaps.

No grandfathering

Individuals with existing exemptions (e.g., a “Series 3 waiver”) will not be grandfathered in; all individuals seeking to act as swap associated persons for registered CPOs or CTAs will be required to satisfy the new swaps proficiency requirements in a timely fashion.

Also, the existing Series 3 licensing requirement will remain a separate requirement, and that requirement is not affected by these new swaps proficiency requirements.

“Short Track” and “Long Track” proficiency requirements

The NFA’s new rules establish two different tracks, a “Long Track”² and a “Short Track,”³ for achieving swaps proficiency by the compliance date. Associated persons of covered CPOs and CTAs (e.g., hedge fund managers with swaps activity that are NFA members) will only need to complete the Short Track requirements (in other words, fewer modules will be required). In both cases, the requirements will be satisfied through training modules administered online (see below).

Tutorials, not examinations

The format of the swaps proficiency program differs from the traditional Series 3 examination requirements imposed on associated persons who engage in solicitation activities in several ways:

- The swaps proficiency requirement is not an “examination” per se. It is, rather, a set of online instructional modules that must be completed in order to claim proficiency in the related subject matter.
- While a module may have a quiz that must be passed to complete it, the material for the quiz is drawn from the module itself, and not from a syllabus or study guide.
- The modules may be taken from any internet-accessible computer — it is not necessary to report to a testing center to sit for an examination.
- The modules may be taken in any order and completed at different times.

Next steps

Compliance officers at NFA members should take advantage of the ample lead time provided by the NFA to prepare for this new licensing requirement. Among other things, legal and compliance personnel should:

- Confirm whether the firm itself falls within the scope of this new requirement (i.e., is there swaps activity?);

- Read the NFA’s updated rules, the related interpretive notice, and the associated “frequently asked questions”;
- If the firm falls within scope (or if it is possible or likely that it will fall within scope), determine which individuals will be engaged in associated person activities and therefore will be required to demonstrate swaps proficiency;
- Identify which supervisors of those associated persons will be required to demonstrate swaps proficiency;
- Begin the educational effort and provide a description of the process to forestall panicked responses to a “new examination requirement”;
- Include a summary of progress in satisfying this new obligation to the firm’s 2019 annual compliance review; and
- Add Jan. 31, 2020 (the target date for exam material availability on the NFA website) and Dec. 31, 2020 (a month in advance of the Jan. 31, 2021 compliance deadline) to the firm’s compliance calendar.

Impact and implications

In the past few months, the NFA has taken several significant steps to solidify its role as an active and effective regulator of private fund managers active in the commodity futures and swaps markets. In addition to this swaps proficiency requirement, the NFA recently announced⁴ new requirements for segregation of financial responsibilities within a manager, as well as enhanced cybersecurity obligations. The NFA also continues to actively examine managers and conduct on-site examinations in the United States, the United Kingdom and Hong Kong, underscoring the need for timely adoption of policies and procedures required by any new rulemaking.

Legal and compliance officers at private fund managers that are NFA members who have not made NFA and CFTC compliance a priority in their overall compliance programs should use the remainder of 2019 as an opportunity to catch up. **THFJ**

FOOTNOTES

1. See NFA Interpretive Notice 9075; NFA Bylaw 301 and Compliance Rule 2-24: Proficiency Requirements for Swap APs; see also Swaps Proficiency Requirements FAQs.
2. The Long Track will consist of eight modules: (i) Swap Products and Applications; (ii) Regulation of the Swaps Market; (iii) Onboarding; (iv) Transactional Disclosures; (v) Anti-Fraud and Ethical Practices; (vi) Trade; Execution/Clearing/Margin; (vii) Risk Management; and (viii) Supervision.
3. The Short Track will consist of four modules: (i) Swaps Products and Applications; (ii) Regulation of the Swaps Market; (iii) Supervision; and (iv) Compliance, Anti-Fraud, and Other Requirements.
4. See "NFA Update: New Supervision and Cybersecurity Obligations for Private Fund Managers Registered with the National Futures Association," SRZ Alert, Feb. 1, 2019.