

Commodity Futures Trading Commission Issues Time-Limited Relief from CFTC Rule 1.56

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The Commodity Futures Trading Commission (CFTC) issued [Letter No. 20-28](#) on Sept. 15, 2020. Letter 20-28 addresses issues of relevance both for futures commission merchants (FCMs) as well as asset managers trading separate accounts on behalf of institutional customers. Letter 20-28 provides limited interpretive and no-action relief from certain provisions of CFTC Rule 1.56 – Prohibition of guaranties against loss. Letter 20-28 is the latest regulatory response triggered by a pair of regulatory alerts (Alerts) issued by the Joint Audit Committee (JAC). The JAC includes representatives from CME Group, ICE Futures and the National Futures Association.

Rule §1.56 is intended to prevent an FCM's customers from trying to segregate losses in one account from being offset against assets in another account for the same customer. Rule 1.56 states in relevant part that:

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| (b) | No futures commission merchant or introducing broker may in any way represent that it will, with respect to any commodity interest in any account carried by the futures commission merchant for or on behalf of any person: |
| (1) | Guarantee such person against loss; |
| (2) | Limit the loss of such person; or |
| (3) | Not call for or attempt to collect |

initial and maintenance margin as established by the rules of the applicable board of trade.

- (c) No person may in any way represent that a futures commission merchant or introducing broker will engage in any of the acts or practices described in paragraph (b) of this section.

...

The JAC initially issued the Alerts on March 14, 2019, to address the treatment of separate accounts for margin purposes and the prohibition against loss guarantees by registered FCMs. In addition to multiple accounts held by one customer, Rule 1.56 recognizes that in some cases, FCMs may enter into arrangements with certain customers to forbear from taking all available remedial action to correct a margin deficiency arising in accounts of such customers.

The Alerts were intended to “serve as [a] reminder[s]” to FCMs that separately managed accounts in the same regulatory account classification and held for the same beneficial owner “should be combined for margin purposes,” and that any limited recourse or nonrecourse clauses in an FCM customer agreement “are not in compliance with industry regulations and are not permitted.” CFTC initially responded to the Alerts by issuing [Letter No. 19-17](#) and an accompanying release dated July 10, 2019, and a subsequent public statement by two CFTC division directors dated Sept. 13, 2019, granting time-limited no-action relief from applicable provisions of Rule 1.56 until June 30, 2021, provided that “FCMs and their customers ... find solutions that satisfy the Commission’s requirements ... by September 15, 2020.”

With respect to the relationship between Rule 1.56’s separately managed account requirements and FCM customer account documents, Section II.B of Letter 20-28 states that an FCM and its clients (or clients’ third-party managers) may agree on a protocol whereby an FCM takes certain steps before using assets in one account to cover margin calls in another account of the same beneficial owner. Although Letter 20-28 does not detail specifically what such steps are, it requires that “the FCM must retain ... the discretion to ... [accelerate] the FCM’s protocol for liquidation or for accessing funds in the other accounts of the beneficial owner held at the FCM.”

Section II.C of Letter 20-28 provides no-action relief where an FCM’s customer account documentation includes language that could be viewed as limiting the FCM’s implementation of remedial measures regarding undermargined accounts. CFTC will not recommend enforcement action for agreements entered into before March 31, 2021, provided that the FCM obtains a legal opinion or well-reasoned memorandum from outside counsel by such date, stating that its customer agreements do not:

- (i) guarantee the beneficial owner against loss;
- (ii) limit the loss of the beneficial

owner; or

- (iii) prohibit the FCM from calling for or attempting to collect initial and maintenance margin as established by the rules of the applicable board of trade.

Even if an FCM's customer documentation contains provisions that could be construed as representations to limit recourse in violation of Rule 1.56, Letter 20-28 states that CFTC staff would consider such a violation to be cured if the FCM promptly discloses in writing to the client(s):

- (i) that Rule 1.56 provides that the FCM may not represent that it will guarantee a beneficial owner against loss, limit the loss of the beneficial owner or prohibit the FCM from calling for or attempting to collect initial and maintenance margin as established by the rules of the applicable board of trade; and
- (ii) an explanation of the FCM's reliance on applicable law and severability of contractual provisions in order to be in compliance with Rule 1.56.

Letter 20-28 provides various pathways for FCMs to comply with Rule 1.56. FCMs may want to consider reviewing their customer account documentation to determine whether the language is ambiguous or whether regulatory relief is available. Letter 20-28 makes clear that such relief will not be available after March 31, 2021.

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