

June 13, 2019

Joint Audit Committee’s Regulatory Alert Potentially Affecting Separately Managed Account IMAs

On May 14, 2019, the Joint Audit Committee (the “JAC”), a representative committee consisting of U.S. derivatives exchanges and clearing houses and the National Futures Association, issued a [Regulatory Alert](#) concerning the JAC’s interpretation of CFTC Regulation 1.56(b) (“Prohibition of Guarantees Against Loss”) (the “Regulation”).

Background. The Regulation prohibits a futures commission merchant (“FCM”) from, among other things, representing that it will, with respect to any commodity interest in an account carried by the FCM for another person, guaranty such person against loss or limit the loss of such person.

Investment management agreements (“IMAs”) for separately managed accounts (“SMAs”) may include provisions that (i) limit (expressly or implicitly) the investment adviser’s authority to bind the SMA’s beneficial owner’s assets to those assets that are under management by the investment adviser and (ii) restrict the investment adviser from entering into transactions on behalf of the account, if the transactions could result in losses that exceed the amount of the beneficial owner’s assets in the account. Accordingly, many investment advisers have negotiated contractual provisions in their trading documentation with FCMs on behalf of SMA clients that are intended to limit an FCM’s recourse to the beneficial owner’s assets that are managed by the investment adviser.

Purpose of the Alert. The Alert states that it is the JAC’s position that an FCM cannot agree to limit its recourse for losses arising from the futures or cleared swaps to less than all of the assets of the beneficial owner of the SMA. According to the Alert, if an investment adviser incurs losses arising from futures or cleared swaps on behalf of an underlying client (including the beneficial owner of an SMA), under the Regulation, the FCM must have access to all of the underlying beneficial owner’s assets, including assets in other accounts of the same beneficial owner managed by the investment adviser, as well as assets of that beneficial owner managed by other investment advisers.

Observations. If they have not already, investment advisers that manage SMAs may want to consider reviewing the related IMAs to determine whether an amendment is necessary. Such an amendment would clarify that, if the investment adviser causes the SMA to enter into futures or cleared swap transactions, the FCM may be able to access assets of the beneficial owner of the SMA outside of the assets in the SMA. Prospectively, investment advisers should keep the Regulation and the Alert in mind when negotiating IMAs and amend relevant written policies and procedures as needed.

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For further information about how the issues described in this Alert may impact your interests, please contact your regular Ropes & Gray contact.