

# Client Alert.

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January 9, 2015

## CFTC Staff Issues CCO Annual Report Advisory and Related No-Action Relief

By Julian Hammar

On December 22, 2014, the Division of Swap Dealer and Intermediary Oversight (“DSIO”) of the Commodity Futures Trading Commission (“CFTC”) issued an Advisory providing guidance regarding the contents of chief compliance officer (“CCO”) annual reports required to be submitted to the CFTC by futures commission merchants (“FCMs”), swap dealers (“SDs”), and major swap participants (“MSPs”) (collectively, “registrants”). CCO annual reports must be (i) furnished to a firm’s Board of Directors (“Board”) or senior officer prior to submission to the CFTC, (ii) certified by the CCO or the firm’s chief executive officer, and (iii) contain information specified in CFTC Regulation 3.3(e), 17 C.F.R. 3.3(e). Based on CFTC staff review of CCO annual reports submitted in the first year, the Advisory provides guidance and recommendations for best practices with respect to future annual report filings and Reg. 3.3(e)’s content requirements. While DSIO emphasizes that the Advisory is not intended to create new regulatory requirements, and the recommendations and best practices in the Advisory need not be used if the CCO does not believe they will improve the annual report, DSIO will expect most FCMs, SDs, and MSPs to incorporate its recommendations into their CCO annual reports.

Among other recommendations, the Advisory suggests that the CCO annual report should include a summary chart to display information addressing various requirements and includes a sample chart. However, DSIO states that, while charts may be appropriate to efficiently display information, they are not a substitute for a complete and substantive discussion of the material issues that must be addressed in the annual report to fully inform the Board or senior officer regarding the registrant’s compliance program. The extended discussion of such charts in the Advisory, though, suggests that staff prefers to see such charts in the annual report. CFTC staff uses regulatory charts in other contexts (e.g., Form DCM, Exhibit L requires a regulatory chart in a contract market designation application) because they assist staff in conducting their review, which appears to be the motivation here. Some information that DSIO suggests may be useful to be displayed in chart form includes:

- An identification of applicable regulatory requirements to which the registrant is subject.
- A description of the firm’s written policies and procedures (“WPPs”) that address each relevant regulatory requirement.
- A cross-reference to the specific page number and section of the WPPs.
- A concise summary assessment of the effectiveness of the firm’s WPPs with respect to each requirement.
- The method used to assess effectiveness (e.g., testing, routine monitoring, self-reports, certifications or attestations, and/or internal audits).

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The Advisory also suggests that substantially more detail should be included in the narrative description of the CCO's annual report than was included in the first year's filings. A summary table containing the Advisory's specific recommendations and guidance is provided below.

The Advisory is available [here](#).

Concurrently with the issuance of the Advisory, DSIO issued a no-action letter that permits FCMs, SDs, and MSPs with fiscal years ending on or before January 31, 2015, to file their CCO annual reports within 90 days of their fiscal year end (as opposed to within 60 days as required by CFTC regulations). Firms that are unable to submit the annual reports within 90 days may submit them within 120 days of their fiscal year end, so long as they inform DSIO of any material noncompliance events that occurred during the period covered by the report. The additional time is to permit firms to make adjustments to their annual reports to incorporate information provided in the Advisory.

The no-action letter is available [here](#).

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*Because of the generality of this update, the information provided herein may not be applicable in all situations and should not be acted upon without specific legal advice based on particular situations. Prior results do not guarantee a similar outcome.*

The following table presents in summary format the specific guidance provided for in the Advisory for each requirement in Reg. 3.3(e) for CCO Annual Reports.

**Advisory Guidance Regarding Compliance with CCO Annual Report Requirements**

<b>CFTC Reg. 3.3(e) Requirement</b>	<b>Advisory Guidance</b>
<p><b>Reg. 3.3(e)(1). Description of written policies and procedures (“WPPs”), including the code of ethics and conflicts of interest policies of the FCM, SD, or MSP.</b></p>	<ul style="list-style-type: none"> <li>• <b>WPPs.</b> Describe WPPs at 2 levels:               <ul style="list-style-type: none"> <li>• <b>First Level:</b> A summary overview that describes the general forms and types of WPPs (e.g., compliance manual specific to registrant, global corporate manuals or policies, and/or business-unit-specific WPPs).</li> <li>• <b>Second Level:</b> Include a specific description of each WPP, relaying the specific purposes and operative procedures of the WPP, which may be done in conjunction with the discussion of the requirements of Reg. 3.3(e)(2), below.</li> </ul> </li> <li>• <b>Conflicts of Interest Policy.</b> Describe the conflicts of interest policy specific to the registrant and address requirements of Reg. 1.71 or 23.605, as applicable, in addition to any enterprise-wide conflict of interest policy to which the registrant’s employees may be subject.</li> </ul>
<p><b>Reg. 3.3(e)(2). Review each applicable requirement under the Commodity Exchange Act (“CEA”) and CFTC regulations, and provide specific information with respect to each.</b></p>	<ul style="list-style-type: none"> <li>• Review each applicable requirement and document the results in the annual report.</li> <li>• Closely related requirements may be reviewed jointly, although the report must specify that joint review was conducted.</li> </ul>
<p><b>Reg. 3.3(e)(2)(i). Identify the WPPs that are reasonably designed to ensure compliance with the requirement under the CEA and CFTC regulations.</b></p>	<ul style="list-style-type: none"> <li>• For each WPP, include expiration dates, any mandatory review periods, and identify persons responsible for reviewing.</li> </ul>
<p><b>Reg. 3.3(e)(2)(ii). Provide an assessment as to the effectiveness of these WPPs.</b></p>	<ul style="list-style-type: none"> <li>• <b>Own Activities.</b> Describe the registrant’s own activities in making the assessment, and not rely on external audits or reviews.</li> <li>• <b>Narrative Description.</b> Include a narrative description in the assessment of the processes used to assess the effectiveness of WPPs.</li> </ul>

CFTC Reg. 3.3(e) Requirement	Advisory Guidance
	<ul style="list-style-type: none"> <li>• <b>Methods Used/Conclusions Reached.</b> Disclose the method used to evaluate each requirement and the conclusions reached regarding the effectiveness of WPPs.</li> <li>• <b>Partially or Wholly Ineffective WPPs.</b> If the assessment finds that a WPP is partially or wholly ineffective or could be improved upon, a discussion of the reasons for that conclusion and the steps taken or to be taken to address the issue(s) should be included.</li> <li>• <b>Deficiencies noted by CFTC staff.</b> CFTC staff noted deficiencies regarding assessments in annual reports submitted to date, some of which contained narrative descriptions of the assessment method used and provided a general indication of the effectiveness of all WPPs, but not on a requirement-by-requirement basis. Registrants should address the effectiveness of each WPP.</li> </ul>
<p><b>Reg. 3.3(e)(2)(iii). Discuss areas for improvement, and recommend potential or prospective changes or improvements to its compliance program and resources devoted to compliance.</b></p>	<ul style="list-style-type: none"> <li>• <b>Areas of Improvement.</b> The report should include, as applicable: <ul style="list-style-type: none"> <li>• A detailed discussion of why the CCO believes a particular area needs improvement;</li> <li>• A discussion of the improvements to be implemented and the time frame for their implementation; and</li> <li>• A cross reference to the regulation that a particular change or improvement to the compliance program is designed to address.</li> </ul> </li> <li>• <b>Continuity with Prior Reports.</b> Where a previous report discussed future changes or improvements that were being planned, subsequent reports should discuss the outcomes of the changes, any monitoring or testing of those changes, whether any compliance issues arose from the changes, and, if so, how those issues were handled.</li> </ul>
<p><b>Reg. 3.3(e)(3). List any material changes to compliance policies and procedures during the coverage period of the report.</b></p>	<ul style="list-style-type: none"> <li>• When discussing material changes, include a description of the standard of materiality used.</li> <li>• CCOs should consider grouping requirements by category for ease of discussing material changes to WPPs to the extent they are related.</li> </ul>
<p><b>Reg. 3.3(e)(4). Describe the financial, managerial, operational, and staffing resources set aside for compliance with respect to the CEA and CFTC regulations, including any material deficiencies to those resources.</b></p>	<ul style="list-style-type: none"> <li>• <b>Description of Resources.</b> The description of resources should include the following (including numerical information as applicable): <ul style="list-style-type: none"> <li>• Total budget allocated to the compliance department of the registrant for compliance with the CEA and CFTC regulations (e.g., the amounts allocated for personnel, technology, training, and travel (as applicable));</li> <li>• Total staffing (e.g., full-time employee counts);</li> </ul> </li> </ul>

CFTC Reg. 3.3(e) Requirement	Advisory Guidance
	<ul style="list-style-type: none"> <li>• Partially allocated staff counts (if applicable), with information on how much of such employees' time is devoted to the registrant's compliance matters that are subject to CFTC oversight;</li> <li>• An explanation of managerial resources (the explanation should make clear the division between staffing resources and management resources devoted to compliance);</li> <li>• Detailed infrastructure information (e.g., computers, technology, infrastructure, etc.); and</li> <li>• A detailed description of the CCO's and CEO's prior experiences and educational backgrounds.</li> </ul> <ul style="list-style-type: none"> <li>• <b>Shared Resources.</b> For instances where compliance resources are shared with other organizational units, provide a discussion of the current resources dedicated solely to the registrant and those partially allocated in as much detail as is necessary to demonstrate a full assessment of total resources used for registrant specific compliance activities.</li> <li>• <b>Resource Deficiencies.</b> Regarding resource deficiencies, if the CCO does not believe any material deficiencies exist in compliance resources, a statement should be included to this effect, particularly if there have been changes in the registrant's futures or swaps activities or compliance resources since the last reporting period. <ul style="list-style-type: none"> <li>• For example, if there has been a reduction in compliance staff from the previous reporting period, there was a significant compliance budget decrease or the registrant initiated significant new business activities, the report should include an explanation of why the allocated resources are not deficient in light of the changes.</li> </ul> </li> </ul>
<p><b>Reg. 3.3(e)(5). Describe any material non-compliance issues identified, and the corresponding action taken.</b></p>	<ul style="list-style-type: none"> <li>• Include an explanation of the materiality standard the registrant used.</li> <li>• Describe each material non-compliance issue identified and the compliance actions taken, as well as specific references to the CFTC regulation(s) implicated by the non-compliance event.</li> <li>• Discuss how the registrant reached a decision on a course of remediation, how it was implemented, any follow-up testing of the remediation, and any noteworthy results from such testing.</li> <li>• Include an overview of how the CCO or compliance department handles and tracks non-compliance events in general.</li> </ul>