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CFTC Proposes to Amend Chief Compliance Officer Duties and Annual Report Requirements

By Julian E. Hammar

On May 3, 2017, the Commodity Futures Trading Commission (“CFTC”) approved for publication in the Federal Register proposed amendments to its rules regarding the duties of Chief Compliance Officers (“CCOs”) for swap dealers (“SDs”), major swap participants (“MSPs”), and futures commission merchants (“FCMs”) (collectively, “Registrants”) and content and submission requirements for annual reports (“Proposal”). The overarching goals of the Proposal are to make certain clarifications regarding the rules based on CFTC experience and input from CCOs, to harmonize the CFTC’s rules with similar rules of the Securities and Exchange Commission (“SEC”) applicable to security-based swap dealers,¹ and to reduce regulatory burden for Registrants. The comment period for the proposed rules closes on July 7, 2017. The Proposal, which has been published in the Federal Register,² is available [here](#).

The Proposal would make the following modifications to CFTC Regs. 3.1 and 3.3:

- *Definition of Senior Officer.* CFTC Reg. 3.3(a)(1) requires that a CCO report directly to the board of directors or the senior officer of the SD, MSP, or FCM, but does not define the term “senior officer.”³ The Proposal would define the term “senior officer” in proposed CFTC Reg. 3.1(j) to mean the chief executive officer or other equivalent officer, which aligns with the definition in the SEC’s Rule 15Fk-1 applicable to CCOs of security-based swap dealers.⁴
- *Duty to Administer Policies and Procedures:* CFTC Reg. 3.3(d)(1) states that a CCO’s duties include “administering the registrant’s policies and procedures reasonably designed to ensure compliance” with the Commodity Exchange Act (“Act”) and CFTC Regulations.⁵ The Proposal would amend Reg. 3.3(d)(1) to require a CCO to administer “each of the registrant’s policies and procedures relating to its business as a futures commission merchant, swap dealer, or major swap participant that are required to be established by the Act and Commission regulations.”⁶ The change clarifies that the CCO is required to administer policies specifically relating to the business of the FCM, SD, or MSP, and not all of the Registrant’s business that may otherwise be subject to CFTC regulation. Further, the amendment more

¹ See Business Conduct Standards for Security-Based Swap Dealers and Major Security-Based Swap Participants, 81 Fed. Reg. 29,960 (May 13, 2016).

² Chief Compliance Officer Duties and Annual Report Requirements for Futures Commission Merchants, Swap Dealers, and Major Swap Participants; Amendments, 82 Fed. Reg. 21,330 (May 8, 2017).

³ 17 CFR 3.3(a)(1).

⁴ 17 CFR 240.15Fk-1.

⁵ 17 CFR 3.3(d)(1).

⁶ 82 Fed. Reg. at 21,332.

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closely tracks a parallel requirement in SEC Rule 15Fk-1(b)(4) applicable to security-based swap dealers.⁷

- *Resolving Conflicts of Interest:* CFTC Reg. 3.3(d)(2) requires a CCO, in consultation with the board of directors or the senior officer, to resolve any conflicts of interest that may arise.⁸ A strict reading of the rule would require the CCO to personally resolve every potential conflict of interest. The Proposal would modify Reg. 3.3(d)(2) to clarify that the CCO must take “reasonable steps” to resolve conflicts.⁹ The CFTC states that this amendment makes explicit an implied reasonableness standard and recognizes that resolution of non-material conflicts need not always require the CCO’s direct expertise or directly involve the board of directors or senior officer. It is also consistent with the SEC’s parallel rule,¹⁰ and the CFTC endorses the SEC’s explanation in using the reasonable steps language in its rule that resolving conflicts of interest would likely include the recommendation of actions to resolve the conflict, as well as escalation and reporting of issues related to resolution, but not executing business decisions to ultimately resolve the conflict.¹¹
- *Ensuring Compliance:* CFTC Reg. 3.3(d)(3) requires CCOs to take “reasonable steps to ensure compliance” with the Act and CFTC Regulations relating to the SD’s or MSP’s swaps activities or an FCM’s business as an FCM.¹² The Proposal would amend Reg. 3.3(d)(3) to clarify that the CCO’s duty includes ensuring that the Registrant establishes, maintains and reviews written policies and procedures reasonably designed to achieve compliance, again consistent with the parallel SEC rule.¹³ The change is intended to specifically identify the CCO’s duties with regard to compliance policies and procedures.
- *Remediation of Noncompliance Issues:* CFTC Regs. 3.3(d)(4) and (5) require a CCO to establish procedures, in consultation with the board of directors or the senior officer, for the remediation of noncompliance issues identified by the CCO and the closing of noncompliance issues.¹⁴ The Proposal would remove the requirement to consult with the board or senior officer.¹⁵ It would also clarify that the procedures be “reasonably designed” to achieve their stated purpose and that the CCO should consult, as appropriate, with business lines, senior management, the board, and independent review groups in managing and remediating compliance issues. Reg. 3.3(d)(4) would also be amended to include remediating matters identified “through any means” in addition to the specific detection methods mentioned in the rule text to provide greater flexibility.
- *Annual Report:* CFTC Regs. 3.3(e) and (f) require that the CCO prepare and file an annual report with the CFTC.¹⁶ The Proposal would make various changes designed to reduce burdens, incorporate related

⁷ 17 CFR 15Fk-1(b)(4).

⁸ 17 CFR 3.3(d)(2).

⁹ See 82 Fed. Reg. at 21,332.

¹⁰ 17 CFR 240.15Fk-1(b)(3).

¹¹ See 82 Fed. Reg. at 21,332.

¹² 17 CFR 3.3(d)(3).

¹³ See 82 Fed. Reg. at 21,332-33. See also 17 CFR 240.15Fk-1(b)(2).

¹⁴ 17 CFR 3.3(d)(4) and (5).

¹⁵ See 82 Fed. Reg. 21,333.

¹⁶ 17 CFR 3.3(e) and (f).

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proposed amendments as discussed above, and further harmonize with SEC rules.¹⁷ Specifically, the revisions, among other things, would:

- Clarify the policies and procedures the annual report should address by referencing the policies and procedures described in Reg. 3.3(d), as amended;
- Remove the requirement that the annual report identify and assess the policies and procedures for each applicable requirement under the Act and CFTC Regulations and instead require that Registrants provide summaries of the policies and procedures together with a detailed discussion of the Registrant's annual assessment and recommended improvements;
- Limit the description in the annual report of the financial, managerial, operational, and staffing resources allocated for compliance to the specific activities for which the Registrant is registered; and
- Require that the CCO deliver the annual report to the board audit committee (or equivalent), the board of directors, and the senior officer prior to furnishing it to the CFTC.

The Proposal would provide a number of helpful clarifications, reduce burden, and harmonize the CFTC's rules with the SEC's rules, which should provide efficiencies for dually registered entities. Registrants in their comments may want to consider supporting the amendments and, since a number of the proposed changes were in response to input from Registrants, suggesting additional changes that would provide clarification, reduce burden, and promote further harmonization with SEC rules.

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¹⁷ See 82 Fed. Reg. 21,333-34.

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