January 18, 2011

Mr. David A. Stawick
Secretariat
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street NW
Washington, DC 20581

Re: RIN 3038-AC96 and CCO Designation

Dear Mr. Stawick:

National Futures Association appreciates the opportunity to comment on the Commission's proposed rulemaking regarding the designation of a chief compliance officer ("CCO"), required compliance policies, and annual report of a futures commission merchant ("FCM"), swap dealer ("SD"), and major swap participant ("MSP"). While NFA fully supports the regulatory policy behind the requirement to designate a CCO, we have significant concerns with both the approach used to adopt these requirements as applicable to FCMs, and several specific facets of the proposed rulemaking as discussed below and as applicable to FCMs, SDs, and MSPs.

The Commission's release states that the Dodd-Frank Act addresses the compliance activities of certain registrants in detail by requiring each FCM, SD, and MSP to designate a CCO. The Commission further acknowledges that the legislative language that requires FCMs and SDs and MSPs, respectively, to designate a CCO differs between Sections 4d(d) and 4s(k). Yet despite these differences the Commission has determined without explanation to apply the same duties and responsibilities to a CCO of an FCM as are required for a CCO of an SD or MSP.

While NFA may question this approach and believes it is contrary to the legislative language of Sections 4d(d) and 4s(k)[1] and the 2009 regulatory

[1] As the Commission is aware, Section 4s(k) applicable to SDs and MSPs requires the designation of a CCO, and contains specific details as set forth in Section 4s(k)(2)(A)-(G) regarding the CCO's duties and the preparation and filing of an annual compliance report pursuant to Section 4s(k)(3). On the other hand, Section 4d(d) applicable to FCMs is materially different and simply provides as follows:

> Each futures commission merchant shall designate an individual to serve as its chief compliance officer and perform such duties and responsibilities as shall be set forth in regulations to be adopted by the Commission or rules to be adopted by a futures association registered under Section 17.

harmonization initiative of the CFTC and SEC[2], we believe a more important regulatory policy objective for the Commission should be to harmonize any final CCO rule applicable to FCMs, SDs, and MSPs with the securities industry's current approach as contained in FINRA (NASD) Rule 3010 and Interpretive Material 3010-1, FINRA (NASD) Rule 3012, and FINRA Rule 3130, and equally important the regulatory policy behind that approach. To reach this result, and avoid an untenable result with this rulemaking, NFA recognizes that the Commission may have to construe Congressional intent as it did in the Federal Register release with regard to Section 732 of Dodd-Frank relating to conflicts of interest policies.

The securities industry's CCO requirements were proposed at a time of regulatory turmoil in the securities industry. In initially seeking comment on its proposal to amend Rule 3010 in June 2003,[3] NASD stated that "It is not NASD's intent with this proposal to make the Chief Executive Officer and Chief Compliance Officer personally liable for each compliance or supervisory failure a firm might experience." NASD also stated that the proposal was intended to enhance investor protection and that the proposal sought to "facilitate the development of an ethical culture of compliance" within firms by defining a CCO's role and by compelling periodic and significant consultation between senior business and compliance personnel. NASD aimed to foster greater investor protection by providing an independent consultative voice to CCOs in their dealings with other supervisors, managers, and officers of the member whose responsibilities include making sure the member's employees are trained and follow compliance policies and procedures.

NFA believes that the material differences in statutory language between Sections 4d(d) and 4s(k) suggest that Congress did not intend to apply the same duties and responsibilities to a CCO of an FCM as are required for a CCO of an SD or MSP. Certainly, if Congress wanted to treat FCMs identically to SDs and MSPs, then Congress could have amended Section 4d(d) to adopt Section 4s(k)'s language.

[2] If adopted, the Commission's CCO proposal is likely to create exactly the type of duplicative and inconsistent regulatory requirements with respect to the 55% of FCMs that are also registered as broker/dealers that panelists expressed concern about at the SEC-CFTC joint harmonization meetings in September 2009 and that the Commission should attempt to avoid. These panelists' comments generally raised two separate, inter-related concerns: on the one hand, there should be relief from the burden of complying with the duplicative sets of registration, reporting and compliance requirements, but on the other hand, such relief should be appropriately tailored to policy goals such that regulatory gaps are not created. As the Commission is aware, the SEC previously approved a self-regulatory organization requirement—FINRA Rule 3130 and accompanying interpretive material—that requires FINRA members to designate a CCO, and this rule establishes certain responsibilities for the CCO.

[3] See June 3003 NASD Special Notice to Members entitled "Certification by Chief Executive Officer and Chief Compliance Officer."

NFA fully supports this regulatory goal—creating an ethical culture of compliance—and believes it is the primary purpose behind a requirement to designate a CCO and to perform a periodic review of the adequacy of a firm's supervisory procedures. In fact, NFA adopted a requirement nearly twenty years ago aimed at creating this type of culture at our Member firms. In 1991, NFA's Board approved the use of a comprehensive self-audit questionnaire that requires Members on an annual basis to regularly review the adequacy of their supervisory procedures. In adopting this supervisory requirement, the Board stated that the questionnaire should aid Members in recognizing potential problem areas and alert them to procedures that need to be revised or strengthened. The questionnaire must be reviewed by the firm's appropriate supervisory personnel who must sign the questionnaire stating that the Member's operations have been evaluated based upon the questionnaire and attest that the Member's procedures comply with all applicable NFA requirements.

NFA believes most of the requirements contained in proposed Commission Regulation 3.3 are appropriate and will contribute to the policy goal of creating a culture of compliance at FCMs, SDs, and MSPs. For example, in particular, NFA is fully supportive of imposing the following requirements upon FCMs, SDs, and MSPs with the slight refinements noted in *italics*:

- To designate an individual to serve as a CCO who is a principal *provided, however, that the proposed language in Commission Regulation 3.1(a) clarifies that a CCO by virtue of being a principal is not a line supervisor or a person with supervisory authority over business personnel. This could be accomplished by adding this language and the CCO to the list of titles in Commission Regulation 3.1(a)(1) as follows*: *if a corporation, any director, the president, chief executive officer, chief operating officer, chief financial officer, and Chief Compliance Officer;*

- To designate an individual who has the background and skills appropriate for fulfilling the CCO's responsibilities;

- Report to the entity's Board or senior officers, who approve the compensation of the CCO. *NFA encourages the Commission to consider whether additional flexibility could be afforded regarding this rigid reporting structure, provided a firm's business unit is not permitted to impose undue pressure on a CCO regarding either compliance or compensation matters;*

- Establish, in consultation with the Board and senior officers, compliance policies as defined in Commission Regulation 3.1(g);

- Establish, in consultation with the Board or the senior officers, compliance policies and procedures to resolve any conflicts of interest that may arise. *Proposed Commission Regulation 3.1(d) states that the CCO shall "resolve" these conflicts, in consultation with the Board or senior officer; yet, NFA believes the actual resolution of any conflicts should not rest with the CCO alone but with a firm's Board or senior officers, in consultation with the CCO;*

- Establish procedures, in consultation with the Board or the senior officer, for the remediation of non-compliance issues identified by the CCO through a compliance office review, look-back, internal or external audit finding, self-reported error, or validated complaint; and

- Establish procedures, in consultation with the Board or the senior officer, for the handling, developing a management response, remediation, retesting, and closing of noncompliance issues.

NFA, however, has concerns that other requirements contained in proposed Commission Regulation 3.3 need more significant refinement or are not necessarily compatible with the policy goal of creating a culture of compliance. These areas are discussed below.

Designating CCOs and Multiple Responsibilities

The Commission should recognize that compliance expertise may reside with more than one individual in firms. For example, FCMs may have an exchange-traded derivatives CCO, an AML CCO, and a CCO who deals with OTC derivatives clearing. Therefore, NFA believes that similar to FINRA[4] the Commission should consider whether it is appropriate for an entity to designate multiple CCOs. If this were permitted, the entity should be required to define each CCO's primary area(s) of responsibility and each CCO should be required to perform Regulation 3.3's specific duties and responsibilities with respect to their defined area(s). Additionally, NFA believes that Regulation 3.3 should specifically provide that CCO(s) in the performance

[4] See FINRA Rule 3013 and Notice to Members 07-32 (July 2007).

of their duties may consult with other employees, outside consultants, lawyers and accountants to the extent appropriate.

In its release, the Commission also seeks comment on whether the Commission should restrict the CCO position from being held by an attorney (e.g., an in-house or general counsel) who represents the registrant or its Board. The Commission notes that the rationale for this type of restriction is based on the concern that the interests of defending the registrant would be in tension with the duties of the CCO. At this time, NFA does not believe that the Commission should place any further restrictions on who can serve as a CCO as long as the CCO can manage conflicts and discharge his/her other duties in light of their other responsibilities.[5] Moreover, if the Commission does adopt this type of restriction, NFA recommends that the Commission clarify that a CCO is not prohibited from reporting to a firm's general counsel.

NFA is also concerned that the proposed rules do not fully consider the impact of this proposal on smaller firms. NFA therefore believes that it is critical for the Commission to allow, similar to FINRA Rule 3130, FCMs to permit compliance officer(s) to hold any other position within the FCM, including the position of Chief Executive Officer (CEO), provided that the individual can discharge the duties of the CCO in light of their additional responsibilities.

The CCO's Duties

In some respects, NFA believes that the Commission's proposed requirements improperly redefine the duties of a CCO. As a result, FCMs, SDs, and MSPs may have difficulty retaining CCOs who have the background and skills appropriate for fulfilling the responsibilities of the position and who are willing to perform the specified duties as proposed. In particular, NFA does not believe it should be the duty of the CCO as set forth in proposed Regulation 3.3(d)(3) to "ensure" compliance by the FCM, SD, and MSP with compliance policies, and all applicable laws, rules, and regulations, including, but not limited to, the requirements set forth in the Commodity Exchange Act ("Act") and Commission regulations.

The aforementioned requirement appears in effect to convert the CCO into a line supervisor, thereby imposing an obligation on the CCO to supervise a firm's business activities. This conversion is contrary to the need to maintain independence or separation between the CCO and a firm's supervisory personnel. Specifically, when a

[5] See FINRA Rule 3130.

CCO's functions and duties too closely resemble those of line supervisors, firms lose the independent advisory voice critical to creating a culture of compliance.

To that end, FINRA provides an excellent description of the CCO's role and responsibilities in the annotations to Rule 3130 and states as follows:

> A chief compliance officer is a primary advisor to the member on its overall compliance scheme and the particularized rules, policies and procedures that the member adopts. This is because a chief compliance officer should have an expertise in the process of (1) gaining an understanding of the products, services or line functions that need to be the subject of written compliance policies and written supervisory procedures; (2) identifying the relevant rules, regulations, laws and standards of conduct pertaining to such products, services or line functions based on experience and/or consultation with those persons who have a technical expertise in such areas of the member's business; (3) developing or advising other business persons charged with the obligation to develop policies and procedures that are reasonably designed to achieve compliance with those relevant rules, regulations, laws and standards of conduct; (4) evidencing the supervision by the line managers who are responsible for the execution of compliance policies; and (5) developing programs to test compliance with the member's policies and procedures.

NFA believes that FINRA has appropriately described the role and responsibilities of the CCO. The CCO should gain an understanding of the firm's products and services, identify the relevant rules, regulations, laws and standards of conduct pertaining to the products and services; develop, along with the firm's business units, policies and procedures that are reasonably designed to achieve compliance with the relevant rules, regulations, and laws; and develop programs to test compliance. The CCO should not, however, be held to the impracticable standard that must "ensure" a firm's compliance as contemplated in the Commission's proposal.

Rather, as FINRA states the CCO's responsibility is to train the line managers who are responsible for the actual execution and enforcement of compliance policies, and to test their performance of those duties. Certainly, compliance staff under the CCO's direction reviews business activities, transactions, and communications, and identifies deficiencies and weaknesses that are brought to management's attention with recommended solutions. Yet, the ultimate responsibility lies with a firm's management and line supervisors to make any necessary changes. Therefore, NFA disagrees with

the Commission's proposal to the extent that it seeks to expand the CCO's oversight role of a firm's compliance function to one of a line supervisor who is ultimately responsible for the execution of compliance policies.

In other respects, NFA believes that the Commission's proposal could do slightly more to create a strong consultative voice for CCOs in their dealings with a firm's CEO, senior management, and others within a firm. In particular, NFA believes that CCOs (in consultation with other employees, outside consultants, lawyers and accountants) should be required to prepare an annual written compliance report. NFA suggests slight changes to the language proposed in Commission Regulation 3.3(d) to place more of an emphasis on a CCO's role in establishing policies and procedures designed to achieve compliance and less of an emphasis on providing a "description of compliance" or "identifying the policies and procedures that ensure compliance." Again, NFA believes these terms are inconsistent with the CCO's role and impose a standard that simply is not achievable. Therefore, NFA believes that a CCO should be required to file an annual report that describes an FCM's, SD's, and MSP's:

- Processes to establish, maintain, and review policies and procedures reasonably designed to achieve compliance with the Commodity Exchange Act, Commission Regulations, and futures industry self-regulatory organization requirements;

- Review of each applicable requirement under the Act and Commission regulations, and with respect to each (1) identifies the policies and procedures that are designed to achieve compliance with the requirement under the Act and Commission Regulations; (2) provides an assessment as to the effectiveness of these policies and procedures; and (3) discusses areas for improvement, and recommends potential or prospective changes or improvements to its compliance program and resources devoted to compliance;

- Material changes, if any, to compliance policies during the report's coverage period;

- Financial, managerial, operational, and staffing resources set aside for compliance with respect to the Act and Commission regulations, including any deficiencies in resources;

- Material non-compliance issues identified and any corresponding action taken; and

- The roles and responsibilities of its board of directors or senior officers, relevant board committees, and staff in addressing any conflicts of interest.

While NFA recognizes that the aforementioned listed items go beyond the two content requirements listed in Section 4s(k)(3)(A) applicable to SDs and MSPs, we believe that reports containing these items will give a broad view of a firm's compliance procedures, efforts and resources. Moreover, we believe that the Commission should strongly consider closing the loop on creating a culture of compliance by requiring a firm's CEO—and not the CCO—to complete the required certification. As NASD stated in announcing an effective date for NASD Rule 3013[6], "NASD Rule 3013 is intended to bolster attention to members' compliance programs by requiring substantial and purposeful interaction between business and compliance officers throughout the firm." The Commission could accomplish a similar policy goal by requiring the CEO to complete the compliance report's certification. [7]

Lastly, as noted above, while NFA may question the Commission's determination to apply the same duties and responsibilities to a CCO of an FCM as are required for a CCO of an SD or MSP, we believe a more important regulatory policy objective for the Commission should be to harmonize any final CCO rule applicable to FCMs, SDs, and MSPs with the securities industry's current approach as contained in FINRA (NASD) Rule 3010 and Interpretive Material 3010-1, FINRA (NASD) Rule 3012, and FINRA Rule 3130, and equally important the regulatory policy behind that approach. If the Commission, however, elects not to adopt NFA's recommended changes, then we strongly urge the Commission to either adopt the recommended changes for FCMs or as the legislation contemplates allow NFA to adopt the CCO requirement for FCMs subject to Commission approval.

[6] See NASD Notice to Members 04-79 (November 2004).

[7] A CEO certification is also entirely consistent with the Sarbanes-Oxley CEO certification requirement.

If you have any questions concerning this letter, please do not hesitate to contact either Carol Wooding at (312) 781-1409 or cwooding@nfa.futures.org, or the undersigned at (312) 781-1413 or tsexton@nfa.futures.org.

Respectfully submitted,

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