January 18, 2011 **REFILED WITH TECHNICAL CORRECTIONS**

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

Re: Designation of a Chief Compliance Officer; Required Compliance Policies; and Annual Report of a Futures Commission Merchant, Swap Dealer, or Major Swap Participant

Dear Mr. Stawick:

The Futures Industry Association ("FIA")[1] and the Securities Industry and Financial Markets Association ("SIFMA")[2] (collectively, the "Associations") are submitting this letter to provide our comments on the proposal by the U.S. Commodity Futures Trading Commission (the "CFTC" or the "Commission") to adopt rules (the "Proposed Rules")[3] relating to the chief compliance officers ("CCOs") of futures commission merchants ("FCMs"), swap dealers ("SDs"), and major swap participants ("MSPs"), to implement certain requirements included in Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "DFA")[4] that amend the Commodity Exchange Act (the "CEA").[5]

As explained in detail below, the Proposed Rules would establish a compliance framework that is significantly different from that currently in place in the financial services industry under the regulations promulgated by other Federal regulators, including the Securities and Exchange Commission (the "SEC") and the several banking regulators,[6] as well as the compliance model adopted by the Commission itself as recently as September 2010. Further, the CFTC has published other rules for comment under the DFA that would impose additional obligations on CCOs.[7] In

[1] FIA is a principal spokesman for the commodity futures and options industry. FIA's regular membership is comprised of approximately 30 of the largest futures commission merchants in the United States. Among FIA's associate members are representatives from virtually all other segments of the futures industry, both national and international. Reflecting the scope and diversity of its membership, FIA estimates that its members effect more than eighty percent of all customer transactions executed on United States contract markets.

[2] SIFMA brings together the shared interests of hundreds of securities firms, banks and asset managers. SIFMA's mission is to develop policies and practices which strengthen financial markets and which encourage capital availability, job creation and economic growth while building trust and confidence in the financial industry. SIFMA, with offices in New York and Washington, D.C., is the U.S. regional member of the Global Financial Markets Association (GFMA).

[3] *See* Designation of a Chief Compliance Officer; Required Compliance Policies; and Annual Report, 75 Fed. Reg. 70881 (proposed Nov. 19, 2010) (to be codified at 17 C.F.R. §§ 3.1 & 3.3) (the "Proposing Release").

[4] Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. 111-203, 124 Stat. 1376 (2010).

[5] Commodity Exchange Act, 7 U.S.C. 1 *et seq.*

[6] We note that the SEC is also charged with the duty to propose similar rules applicable to security-based SDs and MSPs (*see* Section 764 of the DFA adding Section 15F "Registration and Regulation of Security-Based Swap Dealers and Major Swap Participants" to the Securities Exchange Act of 1934, as well as Section 765 of the DFA).

[7] *See e.g.*, Protection of Collateral of Counterparties to Uncleared Swaps; Treatment of Securities in a Portfolio Margining Account in a Commodity Broker Bankruptcy, 75 Fed. Reg. 75432, 75434 (proposed Dec. 3, 2010); *see also* Core Principles and Other Requirements for Swap Execution Facilities, 76 Fed. Reg. 1231-35 (proposed Jan. 7, 2011);

light of the Associations' extensive comments on the Proposed Rules, and in order to afford commenters the opportunity to assess adequately all of the obligations that the CFTC has proposed to impose on CCOs, the Associations respectfully request that the Commission publish for an additional short comment period any revisions that it may make to the Proposed Rules and any other proposed rules that may impose obligations on CCOs.[8]

Our comments: (1) highlight the instances where the Proposed Rules have gone beyond the DFA's mandate with respect to regulations relating to the duties of CCOs; (2) clarify what we believe was Congress's intent in promulgating Section 731(k) and 732(d) of the DFA[9]; and (3) suggest alternative language for the CFTC to consider in promulgating its final rules on CCOs. We hope that our comments will foster the development of a new rule proposal that will achieve the DFA's goals of improving accountability and transparency, and its call for sound supervisory and compliance practices, while avoiding unnecessary issues and burdens on firms. Additionally, we believe that our suggested revisions would encourage a "system of effective self-regulation of … market participants and market professionals under the oversight of the Commission," the first identified purpose of the CEA.[10]

Executive Summary

While the Associations support the Commission's efforts to provide a strong framework for the compliance activities of FCMs, SDs, and MSPs, we believe that the rules proposed by the CFTC to implement Sections 731(k) and 732(d) of the DFA go well beyond the mandate laid out in the DFA, and in some ways the language of the Proposed Rules appear to misconstrue the provisions and the intent of these sections. Most importantly, the Proposed Rules, as currently drafted, are not consistent with the established compliance models applicable to financial services firms in the U.S. Thus, as elaborated further below, we believe that:

- **The Proposed Rules Should Not Ignore Well-Established Compliance Practices.** In crafting final rules, the Commission should closely examine and carefully consider existing precedents, particularly the broker-dealer, investment adviser, and banking compliance models (collectively, the "financial services model"). The financial services model is universal, broad-based, long established, pervasive, robust, tested in courts and has been implemented by a wide range of firms in the U.S. financial services industry, including FCMs, broker-dealers, banks, investment advisers, and many others.

Governance Requirements for Derivatives Clearing Organizations, Designated Contract Markets, and Swap Execution Facilities, 76 Fed. Reg. 722, 726, 730, 734 (proposed Jan. 6, 2011); Swap Data Repositories, 75 Fed. Reg. 80898, 80912-15 (proposed Dec. 23, 2010); Information Management Requirements for Derivatives Clearing Organizations, 75 Fed. Reg. 78185, 78195 (proposed Dec. 15, 2010); General Regulations and Derivatives Clearing Organizations, 75 Fed. Reg. 77576, 77587-88 (proposed Dec. 13, 2010); Regulations Establishing and Governing the Duties of Swap Dealers and Major Swap Participants, 75 Fed. Reg. 71397, 71406-07 (proposed Nov. 23, 2010); Registration of Foreign Boards of Trade, 75 Fed. Reg. 70974, 70995 (proposed Nov. 19, 2010); Requirements for Derivatives Clearing Organizations, Designated Contract Markets, and Swap Execution Facilities Regarding the Mitigation of Conflicts of Interest, 75 Fed. Reg. 63732, 63721-42 (proposed Oct. 18, 2010); Regulation of Off-Exchange Retail Foreign Exchange Transactions and Intermediaries; Final Rule, 75 Fed. Reg. 55410, 55413, 55447 (Sept. 10, 2010). All of these rules should be consistent.

[8] As an aside, we also note that the Proposed Rules are misnumbered (*see* §3.3(d) and (d), *et seq.*).

[9] Section 731(k) of the DFA (which adds Section 4s(k) to the CEA) and Section 732(d) of the DFA (which adds Section 4d(d) to the CEA) set forth requirements applicable to chief compliance officers of SDs, MSPs, and FCMs. Unless otherwise noted, references to statutory sections in this letter use the DFA section reference (*i.e.*, Section 731 rather than 4s).

[10] *See* 7 U.S.C. § 5(b).

- **The Proposed Rules Should Not Make the CCO a Supervisor and Should Not Fundamentally Change the Role of the CCO.** Unless revised, the Proposed Rules will fundamentally change the role of the CCO by causing the CCO to be deemed a business-line "supervisor." The CCO traditionally acts as an independent advisor to the firm's business-line supervisors, who have the authority to supervise the firm's business activities and are ultimately responsible for making sure that the firm's employees act in compliance with Applicable Law (as defined below). By eliminating the separation between supervision and Compliance traditionally imposed by financial services firms, the Proposed Rules would put an end to the independence necessary to perform the CCO function effectively, and would undermine the long-standing regulatory principle that it is the business managers who have the supervisory responsibility in the firm, not the CCO.

- **The Proposed Rules Should Clarify the CCO's Duty to "Ensure" Compliance.** The Proposed Rules impose on the CCO the duty of "reviewing and ensuring compliance." Based on our understanding of the common usage of the word "ensure," *i.e.*, to guarantee,[11] this requirement goes well beyond any existing compliance model and creates a standard that is impossible to satisfy. The Proposed Rules should be modified to make clear that the term "ensuring compliance" means taking reasonable steps to adopt, review, test and modify compliance policies and procedures, and not that the CCO guarantees absolute compliance by the firm and every employee. We do not believe that Congress intended to use the term "ensure" to mean "guarantee."

- **The Requirement to Resolve Conflicts Should be Clarified.** The Proposed Rules require the CCO to "resolve any conflicts of interest that may arise." We do not believe that when Congress used the term "resolve" in DFA Section 731(k)(2)(C), it intended to mean "resolve" in the executive or the managerial sense such that the CCO alone would examine the facts and determine and effect the course of action. We believe Congress intended to mean identify, advise, escalate as appropriate and assist senior management in resolving conflicts, and to require putting in place reasonable procedures for the resolution of conflicts. Again, the authority to actually resolve conflicts, like the power to enforce compliance, is a duty that should remain with the firm's senior executives and supervisors.

- **The CEO, not the CCO, Should Certify the Required Annual Report**. The Proposed Rules – but not the DFA – require the Annual Report (as defined below) to include a certification *by the CCO* that, "to the best of his or her knowledge and reasonable belief, and under penalty of law, the information contained in the annual report is accurate and complete." While it is clear from the DFA that the CCO must complete and sign the Annual Report, consistent with the financial services model, established industry practices and the fact that it is the firm's chief executive officer ("CEO") that has the ultimate authority to supervise the activities of the firm and its employees, the Proposed Rules should specify that the required *certification* should be

[11] Merriam-Webster explains that "*[e]nsure, insure, assure, secure mean to make a thing or person sure. Ensure, insure, and assure are interchangeable in many contexts where they indicate the making certain or inevitable of an outcome, but ensure may imply a virtual guarantee <the government has ensured the safety of the refugees> . . ., while insure sometimes stresses the taking of necessary measures beforehand <careful planning should insure the success of the party>, and assure distinctively implies the removal of doubt and suspense from a person's mind <I assure you that no harm will be done>. Secure implies action taken to guard against attack or loss <sent reinforcements to secure their position>.*" *See* http://www.merriam-webster.com/dictionary/ensure.

made by the CEO, not the CCO. Further, we note that because the Annual Report may potentially contain highly confidential information, the CFTC should clarify that the Annual Report should not be publicly available and should not be subject to disclosure under the Freedom of Information Act ("FOIA").[12]

- **The Requirement for a Description of Policies and Procedures that "Ensure Compliance" in the Annual Report Should Mean a Description of Reasonable Compliance Policies and Procedures**. The Proposed Rules require the Annual Report to contain a description of the firm's compliance with respect to the CEA and CFTC regulations, and each of the firm's compliance policies and procedures. We believe that Congress intended the phrase "description of the compliance" of the firm in DFA Section 731(k)(3)(A) to mean a description of compliance policies, procedures, programs and other measures reasonably designed to result in compliance with the CEA and CFTC regulations. The Proposed Rules should be revised accordingly. In addition, we do not believe that Congress intended the phrase "ensure compliance" in DFA Section 731(k)(2)(E) to mean the absolute guarantee of compliance, but rather – the implementation of compliance policies, procedures and programs that are reasonably designed to result in compliance with the CEA and CFTC rules. The Proposed Rules should be amended to reflect this.

- **CCO Reporting and Supervision Should Be More Flexible**. The Proposed Rules provide that the CCO will report to the firm's board or senior officer, which will approve the CCO's compensation, and that this authority may not be delegated. Given the wide variety of firms that will be subject to the Proposed Rules (ranging from large integrated global financial institutions to small proprietary firms), firms should be free to determine the most appropriate supervisory structure for their CCO; provided that the structure preserves the CCO's independence and authority as a control function, does not result in the firm's business units being able to impose undue pressure on the CCO, and preserves the board's and/or CEO's ultimate supervisory responsibility over CCOs, as required in the DFA. For example, the CCO could report to the chief legal officer or the chief risk officer, or there could be several CCOs for various business units that report to an overall CCO at the holding or parent company level.

- **The CCO Requirements for FCMs, SDs and MSPs Can be Harmonized in a Single Regime Based on the Existing Financial Services Model.** Although the DFA does not expressly apply Section 731(k) to FCMs, the CFTC has proposed to apply the Proposed Rules to FCMs in equal measure. We believe that if the Proposed Rules are modified in the manner suggested herein, a unified set of final rules, based on the existing financial services model, could potentially be applied to FCMs, SDs and MSPs in a manner that is fully in accordance with DFA Sections 731(k) and 732(d).

- **Alternative Regulatory Regime for FCMs**. In the event that the Commission does not modify the Proposed Rules as we suggest, the existing financial services model should at least apply to FCMs, consistent with Section 732(d) of the DFA, particularly in view of the many dually registered broker-dealer/FCMs in the financial services industry. Further, we believe that the National Futures Association (the "NFA") should have primary responsibility for setting compliance standards for FCMs as well as SDs and MSPs, as may be delegated by the Commission.

[12] The Freedom of Information Act, 5 U.S.C. § 552.

- **CCOs Should Not Be Subject to Potential Criminal Liability**. We believe that it is inappropriate for the Commission to state that CCOs may be subject to criminal liability as a result of carrying out their duties because: (i) there is no indication that Congress ever considered the CCOs to be subject to criminal liability under the applicable sections of the DFA; (ii) criminal liability is not specifically a part of the existing financial services compliance model (either the broker-dealer, CFTC's RFED or banking model); (iii) potential criminal liability will make it much more difficult, if not impossible, for firms to hire competent employees who will be willing to serve as CCOs; and (iv) imposition of criminal liability on CCOs with respect to SDs, MSPs and FCMs would create a duplicative, inconsistent, burdensome and unpredictable regulatory environment in many registrants that are subject to and have implemented the existing financial services compliance model.

I. Background.

On November 19, 2010, the Commission published the Proposed Rules in an effort to implement requirements imposed by the DFA regarding the compliance activities of certain registered entities. The Proposed Rules: (1) require each FCM, SD, and MSP to designate a CCO; (2) prescribe the qualifications and duties of the CCO; and (3) require the CCO to prepare an annual report (the "Annual Report") containing an assessment of the firm's compliance efforts and the CCO's certification, under penalty of law, that the compliance report is accurate and complete.[13] While the Associations support the Commission's efforts to provide a strong framework for the compliance activities of FCMs, SDs, and MSPs, we are concerned that the Proposed Rules go well beyond the intent of Congress in adopting the DFA, and fail to give consideration to the robust and effective compliance programs that our members already have in place – programs reasonably designed to detect and deter violations of applicable laws, rules and regulations (referred to herein as "Applicable Law").

We also believe that the Proposed Rules will fundamentally alter the role of the CCO by conflating it with the role of the firm's business supervisors, which would result in a number of negative consequences discussed below. To avoid these consequences, the Commission should harmonize the Proposed Rules with existing practices and compliance models to the maximum extent possible, consistent with the DFA. We suggest herein a number of ways in which this can be achieved.

II. Well-Established Compliance Practices of U.S. Financial Services Companies Provide a Better Model for Implementing the DFA.

In developing rules for compliance programs and the CCO's duties, the Commission is not without ample and long-standing precedent. The existing financial services model is universal, broad-based, long established, pervasive, robust, tested in courts, and has been implemented by any number of various types of firms, such as FCMs, registered retail forex dealers (RFEDs), securities broker-dealers, banks, registered investment advisers, and many others. Firms subject to these various regulatory regimes are: (i) required to designate a CCO; (ii) establish and maintain a system to supervise employees, which system is reasonably designed to achieve compliance with Applicable Law; (iii) annually review firm policies and procedures; and (iv) provide a written report to the firm's board or senior management describing the operation of their compliance policies and

[13] *See* Proposing Release, 75 Fed. Reg. at 70882-84.

procedures, any material changes to them, and any material changes recommended as a result of the review.[14]

A. The Broker-Dealer Model

The most well-developed U.S. financial services compliance model, and the one most applicable to our members (most of which are also broker-dealers or affiliated with broker-dealers), is the one developed to comply with the requirements imposed on broker-dealers by the Financial Industry Regulatory Authority ("FINRA") under the oversight of the SEC (the "broker-dealer model"). It is premised on two key concepts: (i) supervisory responsibility vested in business-unit managers, up to the CEO; and (ii) an independent Compliance function.[15]

The supervisory responsibility aspect is crucial, for business supervisors must understand that they and not Compliance are responsible for the firm achieving compliance with Applicable Law through their ability to hire, fire, compensate, and discipline firm personnel. On the other hand, to be free to assess and to advise the firm's supervisors with respect to compliance with Applicable Law in a truly objective manner, Compliance must be independent of the business units. Moreover, the heart of the broker-dealer model is that there should be processes, policies and procedures that are "*reasonably* designed to achieve" compliance with laws and regulations.

The broker-dealer model is reflected primarily in three related rules -- FINRA (NASD) Rule 3010 and Interpretive Material 3010-1; FINRA (NASD) Rule 3012; and FINRA Rule 3130 and the supplementary material thereto (collectively, the "FINRA Rules").[16] Taken together, they substantially address the objectives of the Proposed Rules. We note two key aspects of the FINRA Rules. First, the required certification is made by the firm's CEO – not the CCO. Second, the FINRA Rules make clear that while the CCO has a "unique and integral role" in the process as "a primary *advisor* to the [firm] on its overall compliance scheme and the particularized rules, policies and procedures that the [firm] adopts,"[17] the "supervisors with business line responsibility are accountable for the discharge of [the firm's] compliance policies and written supervisory procedures."[18] In other words, the FINRA Rules underscore the critical separation of the supervision/CEO function and the compliance/CCO function.

FINRA (NASD) Rule 3010(a) requires broker-dealers to establish and maintain a system to supervise personnel that is reasonably designed to achieve compliance with Applicable Law, which includes designation of principal(s) with authority to carry out the supervisory responsibilities. FINRA (NASD) Rule 3012(a)(1) requires designation of one or more principals to "establish, maintain, and enforce a system of supervisory control policies and procedures" that test and verify

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[14] *See, e.g.*, FINRA (NASD) Rules 3010 & 3012; FINRA Rule 3130; Investment Advisers Act Rule, 17 C.F.R. § 270.38a-1; Investment Advisers Act Rule, 17 C.F.R. § 275.206(4)-7; *see also* Regulation of Off-Exchange Transactions and Intermediaries; Final Rule, 75 Fed. Reg. 55410, 55447 (Sept. 10, 2010) (to be codified at 17 C.F.R. § 5.18(j)); Securities Exchange Act § 15(b)(4)(E)(i); Board of Governors of the Federal Reserve System, SR 08-08 / CA 08-11, Compliance Risk Management Programs and Oversight at Large Banking Organizations with Complex Compliance Profiles (October 16, 2010) [hereinafter *Fed Supervisory Letter 08-08*] (further discussed below).

[15] The compliance function at all but the smallest firms is overseen by a number of professionals. The duties and responsibilities of the CCO and Compliance Department, as a unit, are referred to in this letter as "Compliance."

[16] FINRA is in the process of consolidating NASD rules and relevant NYSE rules into a single rulebook. Those rules that have been incorporated into the consolidated rule book are referred to herein as "FINRA Rules" while those NASD rules that have not yet been consolidated are referred to herein as "FINRA (NASD) Rules."

[17] FINRA Rule 3130.05 (emphasis added).

[18] FINRA Rule 3130.07.

that the firm's procedures are reasonably designed to achieve compliance with Applicable Law. Finally, FINRA Rule 3130(c) requires firms to designate and identify a CCO, and for the *CEO* to certify annually that:

> (1) the firm has processes to establish, maintain and review compliance policies and procedures reasonably designed to achieve compliance with Applicable Law, modify them as necessary, and test effectiveness periodically;
> (2) the CEO had one or more meetings with the CCO in the preceding 12 months;
> (3) the processes are evidenced in a report reviewed by the CEO, CCO, and other necessary officers, which has been submitted to the board and audit committee or will be within a specified period; and
> (4) the CEO consulted with the CCO and such other employees, consultants, lawyers and accountants, to the extent appropriate, in order to attest to statements in the certification.

We note that even though the FINRA Rules require the CCO to register as a "general securities principal," FINRA has explicitly stated that this "does not create the presumption that a chief compliance officer has supervisory responsibilities or is otherwise a control person." [19] Neither the Proposed Rules nor the Proposing Release provide such a clarifying statement, even though there is a fundamental difference in how the term "principal" is understood under the broker-dealer model and in the Proposed Rules.

B. The CFTC RFED Model

The CFTC is also not without its own precedent in establishing standards for CCOs. For example, as recently as September 2010, the CFTC promulgated rules applicable to retail foreign exchange dealers ("RFEDs") pursuant to the 2008 Farm Bill.[20] The RFED Rule requires each RFED to designate a CCO who must certify that the RFED has in place policies and procedures "reasonably designed to achieve compliance with the Act, rules, regulations and orders thereunder."[21]

In the adopting release for the RFED rule, the CFTC notes that "… no comparable requirement [to designate CCOs with potential personal liability] exists for firms engaging in on-exchange transactions…."[22] However, distinguishing from the on-exchange transactions, the CFTC explains that the requirement to designate CCOs is necessary in the context of the retail foreign exchange transactions "… given the history of fraudulent and improper behavior in the retail forex business."[23]

Further, in the RFED Rule itself, the CFTC states that the RFED CCO must certify "… to the Commission and [the NFA] that the [RFED] has in place processes to establish, maintain, review, modify and test policies and procedures reasonably designed to achieve compliance with the Act, rule, regulations and orders thereunder. The certification shall include a statement that the [RFED] has in place compliance processes, and that the [CCO(s)] has apprised the chief executive officer of

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[19] *See* Notice to Members 01-51 n.2 (Aug. 2001); *see also* note 49, *infra* and accompanying text.
[20] Food, Conservation, and Energy Act of 2008, Pub. L. No. 110-246 (2008); *see also* Regulation of Off-Exchange Transactions and Intermediaries; Final Rule, 75 Fed. Reg. 55410, 55413 (Sept. 10, 2010) (the "RFED Rule").
[21] *See* 75 Fed. Reg. at 55447 (to be codified at 17 C.F.R. § 5.18(j)).
[22] *See id.* at 55413.
[23] *Id*. at 55413.

the compliance efforts to date and identify and address significant compliance problems and plans to address those problems."[24]

Note that the RFED requirement does not require the CCO to certify compliance, but only to certify that compliance policies and procedures reasonably designed to achieve (not ensure) compliance were put in place. Also, the RFED Rule recognizes that the certification should be made together with the CEO (otherwise apprising the CEO would be meaningless) and that the NFA should have a role in enforcing the CCO-related provisions of the RFED Rule. Finally, the RFED Rule acknowledges that there could be more than one CCO at the registrant.

C. The Bank Regulation Model

Banks also have developed a well-established and effective compliance model, which again differs significantly from the Proposed Rules and is in most respects very similar to the broker-dealer model. The Basel Committee on Banking Supervision, for example, issued a paper on compliance policies that has been widely followed globally and in the U.S.[25] In that paper, the first principle applicable to Compliance is that "the bank's compliance function should be independent." According to the Basel Committee, "[t]he independence of the head of compliance and any other staff having compliance responsibilities may be undermined if they are placed in a position where there is a real or potential conflict between their compliance responsibilities and their other responsibilities."[26] Thus, while the Basel Committee would permit a compliance officer to be a member of senior management in some circumstances, the Committee cautioned that, in such circumstances, "he or she should not have direct business line responsibilities."[27]

The Committee observed that the bank's senior management, not Compliance, is responsible for ensuring that the compliance policy is followed, including "responsibility for ensuring that appropriate remedial or disciplinary action is taken if breaches are identified."[28] The Basel Committee recognized the significant differences between banks in terms of size and business structure, expressly permitting flexibility in implementing the advice contained in the paper.[29] The Basel Committee stated that the CCO should "have a formal status within the bank to give it the appropriate standing, authority," but should also have "independence."[30] Thus, the Committee states that the responsibilities of Compliance are to:

(1) provide advice, guidance and education;
(2) identify, measure, and assess compliance risk;
(3) monitor and test compliance;
(4) oversee the compliance program; and
(5) oversee any statutory responsibilities.[31]

[24] *Id*. at 55447 (to be codified at 17 C.F.R. § 5.18(j)).
[25] Basel Committee on Banking Supervision, Compliance and the compliance function in banks (April 2005).
[26] *Id*. at 12.
[27] *Id*.
[28] *Id.* at 9-10.
[29] *Id.* at 7-8.
[30] *Id.* at 11.
[31] *Id.* at 13-14.

Domestic bank regulators, including the Federal Reserve, follow the Basel Committee's guidance.[32] Fed Supervisory Letter 08-08 discusses the role of Compliance in a financial holding company (FHC) and critically notes that the CCO is responsible for an enterprise-wide view of Compliance risk. Although the FHC CCO has insight into the other control functions in the FHC and how they are functioning (usually by virtue of being on firm-wide Risk Committees), the CCO is not responsible for policies and procedures, or monitoring or testing of, regulatory risks *that are owned by the firm's other control functions*.[33] In other words, the CCO under Fed Supervisory Letter 08-08 would not be responsible for all regulatory compliance risks that the FHC firm encounters in its daily business – just those that are traditionally defined for the CCO (*i.e.*, rules regarding compliance risks).[34]

The FDIC takes a similar approach. According to the FDIC, "ultimate responsibility of overall compliance with all statutes and regulations resides with the Board," while a compliance officer should develop and review compliance policies, train employees, assess emerging issues, report compliance issues to the board, and ensure corrective action.[35]

D. The Proposed Rules Should Follow the Financial Services Model

Rather than working from the long-standing financial services model already followed by most FCMs, the Commission has proposed an entirely new set of requirements for SDs, MSPs, and FCMs. We do not believe that Congress intended this and we note that, in specifying CCO requirements for FCMs, Congress used far less prescriptive language than it did for SDs and MSPs.[36] Moreover, we believe that the duties imposed by Congress on SDs and MSPs in the DFA are fully consistent with the broker-dealer compliance model specifically, and the existing financial services compliance model generally. We therefore submit that the better approach would be to codify the existing, broker-dealer model-based FCM compliance regime, and incorporate those principles into a corresponding regime for SDs and MSPs. Such a regime could satisfy the requirements of the DFA without contradicting the current one.

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[32] *See* Fed Supervisory Letter 08-08, ("The Federal Reserve's expectations for all supervised banking organizations are consistent with the principles outlined in a paper issued in April 2005 by the Basel Committee on Banking Supervision.").

[33] For example, in the context of a CCO for a SD or MSP, the CCO would not be responsible for drafting policies and procedures around systems entitlements, or necessarily monitoring or testing the effectiveness of SD's or MSP's entitlement policy (*i.e.*, rights of access by various employees to firm's systems containing trade, cleared or other sensitive commercial data). If there are material issues from entitlements, then the CCO would become aware of them through means such as being on the firm's risk committee, or some similar type of firm-wide governance committee.

[34] According to the Federal Reserve, "Compliance independence facilitates objectivity and avoids inherent conflicts of interest that may hinder the effective implementation of a compliance program," and senior management should "implement and enforce the compliance policies and compliance risk management standards that have been approved by the board…." and specifically identified for the Compliance. Fed Supervisory Letter 08-08.

[35] FDIC Compliance Manual, Compliance Management System 2.1-2.2 (June 2009).

[36] Section 732(d) of Dodd-Frank provides only that each FCM "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."

The broker-dealer model reflects the practice of virtually every U.S. registered broker-dealer and most other financial services firms and, because so many FCMs are also registered broker-dealers, or are affiliated with registered broker-dealers, most FCMs have developed effective compliance programs that closely follow the broker-dealer model, or have incorporated their FCM compliance activities into their existing program. Indeed, many integrated firms also use specifically the broker-dealer and generally the financial services model as a basis for Investment Advisers Act and other compliance programs, or incorporate those programs into a single program and thus acknowledge the distinction between business supervision and Compliance functions. There is great utility in establishing a uniform program with centralized oversight (often by a single CCO). Most importantly, the financial services model codifies long-standing principles regarding the role of Compliance and the CCO in financial services firms – that of a trusted but independent adviser to those responsible for running the firm and supervising the activities of its employees. The Proposed Rules, as currently drafted, take the CCO function at FCMs, SDs and MSPs in a significantly different direction from established industry practices.

E. The Proposed Rules Will Fundamentally Change the Role of the CCO

As currently drafted, the Proposed Rules would fundamentally change the traditional role of the CCO of a financial services firm.

1. The Role of the CCO

Compliance provides many unique and critical services to the firm, supporting management's performance of its traditional supervisory responsibilities and the firm's efforts to comply with Applicable Law. Functions generally associated with Compliance include providing advice to business units and other control functions; keeping business units apprised of regulatory developments; advising on the regulatory requirements for new products; assisting management in identifying and addressing conflicts of interest; identifying potential compliance risks and designing ways to address them, including through policies and procedures; and identifying through surveillance and testing improper behavior, material or systemic weaknesses, and potential problems; and, recommending resolutions.[37] One of Compliance's most important functions is assisting firm management in developing policies and procedures for compliance with Applicable Law, and monitoring regulatory developments to keep them up to date. [38]

Compliance also monitors management responses to indications of improper activity, escalating matters to senior levels (up to and including the CEO and/or the Board) if the response appears to be inadequate. In providing each of these services, Compliance and the CCO are acting as advisors to, not as supervisors of, the firm's business units or personnel. They cannot enforce compliance with policies and procedures by the firm's employees and cannot hire or fire employees or set their compensation. The CCO can only escalate compliance issues to firm's senior business unit management.[39]

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[37] *See* Securities Industry Association, White Paper on the Role of Compliance 3-4 (October 2005).

[38] *See id.* at 3. The Proposing Release also seeks comment on the need to insulate CCOs from undue pressure and coercion, and to address possible conflicts among firms' compliance, commercial, and ownership interests. 75 Fed. Reg. at 70882. The broker-dealer model in fact does this by separating the roles of the CCO and supervisors.

[39] Compliance may also perform a number of other functions, including registration of the firm and personnel; diligence on new or potential employees; maintaining watch and restricted lists; handling "information barrier" issues; helping to administer anti-money laundering programs; and acting as primary interface with regulators, handling and responding to

2. The Role of Supervisors

In comparison, supervisors run the business, with the power to hire, fire, compensate, and discipline employees who do not comply with firm procedures or Applicable Law. The SEC has said that a supervisory relationship is found only when it is clear that the putative supervisor "was responsible for the actions of another and that he could take effective action to fulfill that responsibility," and that "the most probative factor" indicating that a person is responsible for the actions of another is "whether that person has the power to control the other's conduct."[40] In financial services firms, the line of supervision is generally clear. Employees report to desk or branch supervisors, who report to more senior managers up to the firm's CEO (or equivalent officer). Each has authority, including the power, alone or with others, to hire, fire, compensate and discipline those persons reporting to them.

CEA Section 13(b) provides that "[a]ny person who, directly or indirectly, controls any person who has violated any provision of this chapter or any of the rules, regulations, or orders issued pursuant to this chapter may be held liable for such violation in any action brought by the Commission to the same extent as such controlled person." Control person liability applies to "one who directly or indirectly controls any person who has violated any provision of the Act (or regulations promulgated thereunder) and who either acted with a lack of good faith or knowingly induced the acts that constitute the violation."[41] In "interpreting Section 13(b) the CFTC has adopted the Securities Exchange Commission's definition of 'control' as 'the possession, direct or indirect, of the power to direct or cause the direction of the management . . . of a person.'"[42]

Similarly, CFTC Rule 166.3 provides that "[e]ach Commission registrant, except an associated person who has no *supervisory* duties, must diligently supervise the handling by its partners, officers, employees and agents (or persons occupying a similar status or performing a similar function) of all commodity interest accounts . . . and all other activities of its partners, officers, employees and agents (or persons occupying a similar status or performing a similar function) relating to its business as a Commission registrant."[43] The rule was intended to make the firm and its supervisors liable for failing to supervise firm employees in that "… all senior APs with *management responsibilities* are therefore responsible for the creation and maintenance of a supervisory and compliance system and may be liable under [CFTC] Rule 166.3 for any failure in that system, including any failure to diligently supervise other high ranking APs."[44] According to the Commission, "to establish that an individual supervisor violated regulation 166.3 . . . it is necessary to show either that respondent had knowledge of wrongdoing and failed to take reasonable steps to correct the problem, or that respondent failed to discharge specific

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inquiries, reviewing documents, arranging meetings, and discussing potential findings with examiners. *See* Securities Industry Association, White Paper on the Role of Compliance 1-7 (October 2005).

[40] *Arthur James Huff*, Exchange Act Release No. 29,017 (Mar. 28, 1991) (concurring opinion of Commissioners Lochner and Schapiro); *see also Monieson v. CFTC*, 996 F.2d 852, 859 (7th Cir. 1993) (control provisions of CEA Section 13(b) are modeled on securities law provisions; thus, interpretations of securities statutes are relevant to interpreting Section 13(b)).

[41] *In re Szach*, [2000-2001 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶28,451 (CFTC Jan. 8, 2001).

[42] *Monieson*, 996 F.2d at 862 (quoting *In re Spiegel*, [1987-1990 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶24,103 at 34,765 n.4 (CFTC Jan. 12, 1988)).

[43] 17 C.F.R. § 166.3 (emphasis added).

[44] *Secondary and Supervisory Liability Under the Commodity Exchange Act: An Update*, The Record of the Association of the Bar of the City of New York 240, 273 (Spring 2001) (emphasis added).

responsibilities of supervision,"[45] and it must first be proven that they "occupied positions that triggered a duty to supervise."[46]

Compliance does not have these powers outside the Compliance Department. Supervisory control over the business resides with those who run the business, from the CEO to business unit managers. The CCO advises and assists them in carrying out their roles (including escalation to the business unit managers), but supervisors decide whether, and if so how, to implement and enforce them.

3. The Proposed Rules Would Change the Role of the CCO

Imposing supervisory responsibilities on CCOs would interfere with their ability to provide independent advice and counsel, and negatively affect their focus. [47] This is the reason that the broker-dealer model contains numerous provisions making clear that the firm's CEO, not the CCO, is the person ultimately responsible for the firm's compliance with Applicable Law. It also would be confusing for integrated firms that share or centralize Compliance resources to be subject to a fundamentally different compliance regime for their FCM, SD, and MSP entities. That is why the broker-dealer model used by most FCMs and most other financial services firms is the one on which the Proposed Rules should be based.

III. Analysis of the Proposed Rule and Suggested Revisions.

Below we address several specific issues addressed by the Proposed Rule and the Proposing Release and suggest alternative ways to formulate the rules in compliance with the requirements of the DFA.

1. Defining the CCO as a Principal

The Associations do not object to designating a CCO. Indeed, most FCMs already have designated a CCO or a person of equivalent function, and to the extent that they or their affiliates are engaged in other financial services business, they already may be subject to similar requirements for those businesses.[48] But the Proposed Rules would also amend the definition of "principal" that applies to registrants under CFTC Regulation Section 3.1(a) to include CCOs, in a manner that could result in them being deemed supervisors.

Section 3.1(a) would continue to list persons currently considered "principals" under CFTC rules, such as general partners, corporate directors, presidents, CEOs, and persons in charge of business units, divisions or functions. These are persons generally understood to be supervisors and have the authority (alone or with others) to hire, fire, compensate, and discipline employees. But the

[45] *Bunch v. First Commodity Corp. of Boston*, [1990-1992 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶25352 at 39,168-39,169 (CFTC Aug. 5, 1992); *see also Sanchez v. Crown*, [2005-2007 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶30,183 at 57,726 (CFTC Jan. 18, 2006).

[46] *Smith v. Betty*, [2007-2009 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶30,605 (CFTC Aug. 15, 2007); *see also Monieson*, 996 F.2d at 862 (CEO liable for failure to supervise under Rule 166.3 because "[h]e was the top link in the supervisory chain, not a disconnected director").

[47] Where compliance officers have been treated as supervisors, they generally had power and authority beyond that usually afforded to compliance officers. *See, e.g., Kirk Montgomery*, Exchange Act Release No. 45161 (Dec. 18, 2001) (power to impose fines and cancel trades); *James J. Pasztor*, Exchange Act Release No. 42008 (Oct. 14, 1999) (power to hire and fire); *First Albany Corp.*, Exchange Act Release No. 30515 (Mar. 25, 1992) (power to remove commissions and impose fines).

[48] *See, e.g.*, FINRA Rule 3130(a); Investment Advisers Act Rule, 17 C.F.R. § 275.206(4)-7; Investment Company Act Rule, 17 C.F.R. § 270.38a-1.

Commission proposes to add CCOs, and to describe them as "any person occupying a similar status or performing similar functions, such as the chief compliance officer, having the power, directly or indirectly, through agreement or otherwise, to exercise a controlling influence over the entity's activities that are subject to regulation by the Commission," thus implying that the CCO has "similar status" to or performs "similar functions" as supervisors. This is not consistent with the CCO's role as explained above.

Requiring CCOs to register as principals goes beyond the requirements in the DFA, and is not necessary in order to codify the CCO's responsibilities. More importantly, defining the CCO with the same term applied to general partners, presidents, CEOs, and persons in charge of business units is incorrect and misleading, again implying that CCOs have supervisory authority when they do not. We therefore submit that the proposed addition of the CCO as a principal should be deleted in its entirety. The requirements of proposed Section 3.3(a) are sufficient to implement the DFA requirement for the designation of a CCO.

Nevertheless, if the Commission believes that principal registration of CCOs is necessary, the language in Section 3.1(a) should be changed to clarify the CCO's distinct status:

> *"(1) If the entity is organized as a sole proprietorship, the proprietor; if a partnership, any general partner; if a corporation, any director, the president, chief executive officer, chief operating officer, chief financial officer, and any person in charge of a principal business unit, division or function subject to regulation by the Commission; if a limited liability company or limited liability partnership, any director, the president, chief executive officer, chief operating officer, chief financial officer, the manager, managing member or those members vested with the management authority for the entity, and any person in charge of a principal business unit, division or function subject to regulation by the Commission; and, in addition, any person ~~occupying a similar status or performing similar functions~~, such as the [entity's] chief compliance officer, [having the responsibility to establish, maintain, review, modify, and test the entity's compliance policies and procedures relating to its activities under the Act, provided that the designation of the chief compliance officer as a principal shall not result in the chief compliance officer being deemed a business line supervisor or otherwise having supervisory authority over business line personnel]; ~~having the power, directly or indirectly, through agreement or otherwise, to exercise a controlling influence over the entity's activities that are subject to regulation by the Commission~~;"* [49]

[49] We acknowledge that FINRA (NASD) Rule 1022(a) provides in relevant part that "each person designated as a Chief Compliance Officer . . . shall be required to register . . . as a General Securities Principal," but the use of the term is not intended to make the CCO a supervisor. This has been clearly stated by FINRA (then NASD) since it first adopted the requirement. *See* Notice to Members 01-51 n.2 (Aug. 2001) ("The chief compliance officer registration requirement does not create the presumption that a chief compliance officer has supervisory responsibilities or is otherwise a control person. As in the past, NASD Regulation will hold a chief compliance officer responsible for supervision only where supervision is his or her responsibility."). We also note that the list of persons defined as "principals" in FINRA (NASD) Rule 1021(b) does not include CCOs. In any event, FINRA has been careful to make clear that "supervisors with business line responsibility are accountable for the discharge of a member's compliance policies and written supervisory procedures." FINRA Rule 3130.07.

2. Requiring the CCO to Enforce Policies and Procedures

Proposed Section 3.3(a) (emphasis added) requires the CCO to have "full responsibility and authority to develop *and enforce* . . . appropriate policies and procedures to fulfill the duties set forth in the Act and Commission regulations." We believe that the word "enforce" should be clarified as we have explained in this comment letter as it is inconsistent with the role of the CCO, and the duty to "enforce" in its supervisory sense is not set forth in Section 731(k) of the DFA.

Given the Congressional intent and the appropriate interpretation of the term "enforce" in this context, the proper way to characterize the CCO's role in the Proposed Rules would be to state, consistent with the broker-dealer model discussed above, that the CCO has responsibility and authority "*to establish, maintain, review, modify, and test the effectiveness of, in consultation with the board of directors or the senior officer, appropriate policies and procedures reasonably designed to achieve compliance with applicable parts of the CEA and the CFTC Regulations thereunder.* " Moreover, given that the term "compliance policies" is defined in proposed Section 3.1(g) as those established "pursuant to the Act and Commission regulations," we believe that this subsection could simply read "full responsibility and authority to establish, maintain, review, modify, and test, in consultation with the board of directors or the senior officer, appropriate compliance policies."[50]

We suggest that the Commission consider the following revision to the language of the Proposed Rule:

> "*§ 3.3* ***Chief compliance officer***.
> *(a) Designation. Each futures commission merchant, swap dealer, and major swap participant shall designate an individual to serve as its chief compliance officer, and provide the chief compliance officer with the full responsibility and authority to* ~~*develop and enforce*~~ *[establish, maintain, review, modify, and test the effectiveness of], in consultation with the board of directors or the senior officer, appropriate [compliance] policies and procedures [reasonably designed] to fulfill the duties set forth in the Act and Commission regulations.*"

3. CCO Reporting Line

Proposed Section 3.3(a) also provides that the CCO will report to the firm's board or senior officer, which will also approve the CCO's compensation, and that the board or senior officer may not delegate that authority. Given the wide variety of firms that will be subject to the Proposed Rules, including large international integrated financial services firms, holding company structures with multiple affiliated businesses in separate legal entities, smaller firms with narrower business models, single-business firms, *etc.*, prescribing a single reporting structure, or even a narrow range of reporting structures, is neither workable nor desirable. Firms should be given the flexibility to determine their own reporting structure, including the way in which CCOs are supervised.

[50] Proposed Section 3.3(a) also requires the firm's board or senior officer to meet with the CCO at least once a year to discuss the firm's compliance policies and the CCO's administration thereof. Given the relevance of the broker-dealer model to this requirement, and the fact that so many of our members are also registered broker-dealers or affiliated with registered broker-dealers, and thus subject to the annual meeting requirement in FINRA Rule 3130, we suggest that meetings conducted in accordance with the requirements of that rule be viewed as satisfying the Proposed Rules' requirement, provided that the subject matter relates to or includes matters relating to the firm's business, in addition to any other matters that may be discussed at the meeting.

We note, for example, that in many firms CCOs report to the firm's Chief Legal Officer, who in turn may report to the firm's senior management or, in some cases, the Audit Committee of the board of directors or the Chief Risk Officer. So long as the structure is reasonably independent and does not result in the firm's business units being able to impose undue pressure on the CCO in terms of compensation or other matters or restrict the CCO from elevating issues as appropriate, firms should be free to determine the most appropriate reporting structure for their CCO.

We suggest that the Commission consider replacing Sections 3.3(a)(1) and (2) with the following language:

> *["… (1) The chief compliance officer shall report periodically to the board of directors or the senior officer of the futures commission merchant, swap dealer, or major swap participant with respect to the matters set forth in this section, and shall meet with the board of directors or the senior officer at least once a year to discuss and review the futures commission merchant's, swap dealer's, or major swap participant's compliance policies and procedures, as defined in Sec. 3.1(g), its compliance efforts as of the date of such meetings; and any significant compliance problems and plans for emerging business areas.*
>
> *(2) With respect to the supervision of the chief compliance officer, including the establishment of and approval of the chief compliance officer's compensation, the futures commission merchant, swap dealer, or major swap participant may in its discretion determine the appropriate structure for such supervision, provided that such structure: (a) is consistent with its system of supervision of other control functions; (b) requires the chief compliance officer to be independent of business-line supervision; and (c) provides for the chief compliance officer to have direct, unrestricted access to the firm's senior management and board of directors for the escalation of compliance matters."]*

4. Specified Duties of the CCO

There are also certain items under proposed Section 3.3(d), "*Chief compliance officer duties*," that we believe should be modified, since they exceed the traditional scope of the CCO function.

Proposed Section 3.3(d)(3) makes the CCO responsible for "reviewing and ensuring" the firm's compliance with compliance policies, and "all applicable rules laws and regulations, including, but not limited to the requirements set forth in the [CEA] and Commission regulations." The latter provision is far too vague and open-ended. It would sweep in, for example, federal, state, and local tax, labor, and other laws and regulations beyond the Commission's jurisdiction, making the CCO responsible for ensuring compliance with those laws and regulations as well. We believe that this provision is not consistent with the Congressional intent, and goes far beyond the proper role and expertise of the CCO. In contrast, DFA Section 731(k)(2)(E) refers only to compliance with "this Act [*i.e.*, the CEA] (including regulations) relating to swaps, including each rule prescribed by the Commission under this section." The Proposed Rules' reference to "all applicable laws" is clearly overbroad and should be confined to the matters set forth in DFA Section 731(k)(2)(E).

Section 3.3(d)(3) imposes on the CCO the duty of "reviewing and *ensuring* compliance."[51] Obviously, the requirement for a CCO to "ensure" compliance goes well beyond the financial services model – it is not a standard to which even supervisors would be held. The use of the term to describe the CCO's duties, without any guidance, limitation, or definition as to the meaning or scope of the term in this context, would result in an obligation that is simply impossible to satisfy. Indeed, the Commission makes the "fundamental acknowledgement" that the CCO can only "ensure" compliance "to the full capacity of an individual person."[52]

We acknowledge that DFA Section 731(k)(2)(E) states that the CCO must "ensure compliance"; however, we believe that in drafting that provision, Congress intended to require the CCO to oversee the implementation of compliance policies, procedures and programs that are reasonably designed to result in compliance with the CEA and CFTC rules and to report to management when issues arise, not to require the CCO to guarantee absolute compliance or make the CCO a surety of absolute compliance by the firm and every employee.[53] No one could conceivably do that. We therefore submit that the Proposed Rules should include a provision that states:

> [*"For purposes of the Act and this Section 3.3, the term 'ensuring compliance' shall mean taking reasonable steps to establish, maintain, review, modify, and test the effectiveness of compliance policies as defined in Section 3.1(g)."*]

Further, Section 3.3(d)(2) requires the CCO to resolve "any conflicts of interest that may arise." We believe that in inserting similar language in DFA Section 731(k)(2)(C), Congress meant to require the establishment of reasonable procedures for the resolution of conflicts together with the executives of the firm, not to require the CCO to resolve them alone. Again, the authority to actually resolve conflicts, like the power to enforce compliance, is reserved to the firm's senior executives and supervisors.

5. The Annual Report

The Proposed Rules require the CCO to annually prepare a written report that covers the firm's most recently completed fiscal year, and provide it to the board or the senior officer. They set forth seven detailed items to be included in the report, as well as a certification by the CCO that, "to the best of his or her knowledge and reasonable belief, and under penalty of law, the information contained in the annual report is accurate and complete." There are certain critical issues with respect to the Annual Report requirements[54] that the Commission must address.

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[51] *See* Proposing Release, 75 Fed. Reg. at 70887 (to be codified at 17 C.F.R. § 3.3(d)(3)).

[52] Proposing Release, 75 Fed. Reg. at 70883.

[53] We also note that Proposed Rules Section 3.3(d)(4) discusses the "remediation of non-compliance issues," a clear recognition that no CCO, supervisor, or anyone else will be able to "ensure" complete compliance all times with all requirements, and that the "reasonableness" standard of the broker-dealer model is more appropriate. Furthermore, Proposed Rules Section 3.3(d)(5) discusses "management response" to remediation of noncompliance issues. Not only is this further recognition that *non*-compliance is inevitable, it also acknowledges that firm *management* has responsibility for implementing supervisory and compliance policies.

[54] The Proposing Release actually refers to two different subsections of the Proposed Rules as 3.3(d) – "*Chief compliance officer duties"* and "*Annual report."* We presume that the section titled "*Annual report"* should be referenced as 3.3(e) and the section relating to "*Furnishing the annual report to the Commission*" as 3.3(f).

a. Certification

We acknowledge that DFA Section 731(k)(3)(A) mandates the CCO to "annually prepare and sign a report" describing the firm's compliance with the CEA and its policies and procedures, and that Section 731(k)(3)(B) requires the report to "include a certification, under penalty of law, that the report is accurate and complete." However, although Section 731(k)(3)(A) requires the CCO to prepare and sign the report, Section 731(k)(3)(B) does not specifically state or mandate that the required certification must itself be made by the CCO, only that it be included in the report.

There is an obvious comparison to be made with the annual certification required under the broker-dealer model, where the certification is required to come from the CEO, because the CEO is the firm's senior officer and business manager and thus the person who ultimately should be responsible for any certification regarding firm compliance.[55] In fact, in approving the FINRA requirement, the SEC stated that the CEO certification requirement "will help motivate firms to keep their compliance programs current with business and regulatory developments,"[56] a clear statement that the best way to achieve the goal of robust, effective compliance programs is by making the most senior officer ultimately responsible.

The onerous nature of the certification requirement is underscored by the potential of personal criminal liability of CCOs, which is further discussed below.

Accordingly, we suggest that the Commission consider the following revision to the language of the Proposed Rule in Section 3.3(e)(3) [to be renumbered (f)(3)]:

> *"(3) The report shall include a certification by the [chief executive officer] ~~chief compliance officer~~ that, to the best of his or her knowledge and reasonable belief, and under penalty of law, the information contained in the annual report is accurate and complete."*

b. Elements of the Annual Report

The Proposed Rules' content requirements for the Annual Report go well beyond those set forth in DFA Section 731(k)(3), which, in addition to the aforementioned certification requirement, specifies only that the report contain a description of the firm's compliance with respect to the CEA and of each firm policy and procedure (including its code of ethics and conflict of interest policies). In contrast, the Proposed Rules specify 7 far more detailed requirements (provided immediately below as underlined subheadings).[57]

Further, the Associations would like to note that in proposing a core set of minimum requirements for the mandatory items included in the Annual Report, the Commission should acknowledge that a "one-size-fits-all" approach may not be universally appropriate for all registrants, given that some of the SDs, MSPs and FCMs are: (i) public, while others are not public reporting companies; (ii) entities with many customers, while others do not service customers and act only as proprietary

[55] *See* FINRA Rule 3130(b).

[56] Securities Exchange Act Release No. 50347, at 10.

[57] *See* Proposing Release, 75 Fed. Reg. at 70887. The requirements for the annual report appear in proposed sections 3.3(d)(1)-(7). Note that the Proposed Rule incorrectly numbers both consecutive sections as (d), while the sub-section contacting the 7 subheading should be correctly numbered as (e).

traders; (iii) entities with retail customers, while others deal only with other sophisticated counterparties; and (iv) small local proprietorships, while others are large integrated financial institutions with thousands of employees across the globe.

Apart from the time and effort required to prepare the report (which we believe will far exceed the Commission's estimates set forth in the Proposing Release[58]), we believe that the Proposed Rules' requirements raise several interpretative and judgmental questions as discussed below.

1) "Contain a description of the compliance by the futures commission merchant, swap dealer, or a major swap participant with respect to the Act and Commission regulations and each of the registrant's compliance policies, as defined in §3.1(g)".[59]

We acknowledge that DFA Section 731(k)(3)(A)(i) requires the CCO prepare an annual report that provides a "description" of the firm's "compliance"; however, we believe that Congress used the phrase "description of the compliance" to refer to the description of compliance policies, procedures, programs and other measures that are reasonably designed to result in compliance with the CEA, including the firm's efforts to establish, maintain, review, modify, and test the effectiveness of the firm's compliance policies and procedures, and remedy any material shortcomings identified in each compliance review. We do not believe that the term is meant to require a description of "compliance" in the absolute sense.

Accordingly, we propose the following alternative definition of "compliance policies" in Section 3.1(g) of the Proposed Rule:

> *"(g) Compliance policies [and procedures]. Compliance policies [and procedures means material written policies, procedures, codes (including a code of ethics), safeguards, rules, programs, and internal controls required to be adopted or established by a registrant pursuant to the Act and Commission regulations reasonably designed to achieve compliance with applicable provisions of the Act, Commission regulations or applicable rules adopted by a futures association registered under Section 17 of the Act.]"*

2) "Review each applicable requirement under the Act and Commission regulations, and with respect to each: (i) Identify the policies and procedures that ensure compliance with the requirement under the Act and Commission regulations; (ii) Provide an assessment as to the effectiveness of these policies and procedures; and (iii) Discuss areas for improvement, and recommend potential or prospective changes or improvements to its compliance program and resources devoted to compliance".[60]

Again, as discussed above, we do not believe that the Proposed Rules should (or can) require a firm to identify policies and procedures that "ensure" compliance with "each" applicable requirement of the Act and the Commission regulations. Because it is impossible to actually ensure compliance, a point made clear by the Proposed Rules' requirement to describe non-compliance issues identified by the firm, we believe that in using the phrase "ensure compliance" in DFA Section 731(k), Congress was referring to the implementation of compliance policies, procedures and programs that

[58] See our discussion below of expected costs and time expenditure to comply with the Proposed Rules.
[59] *See* Proposing Release, 75 Fed. Reg. at 70887 (to be codified at 17 C.F.R. § 3.3(e)(1)).
[60] *See* Proposing Release, 75 Fed. Reg. at 70887 (to be codified at 17 C.F.R. § 3.3(e)(2)).

are reasonably designed to result in compliance with the CEA and CFTC rules, and we suggest that the requirement be amended to reflect this.

We also recommend that the CFTC specify the key and material areas that should be discussed in the report, at a minimum, in order to have consistency across all registrants (provided that there is enough flexibility so that various forms of registrants are not subject to a "one-size-fits-all" compliance model).[61]

Alternatively, the CFTC could provide a specific list of topics that it expects to be included in the Annual Report (while leaving room for customized compliance programs of various registrants), so that there is less margin for errors of omission, or for "second guessing" with respect to the adequacy of the Annual Report.[62]

3) "Provide a statement of certification of compliance with sections 619 and 716 of the Dodd-Frank Wall Street Reform and Consumer Protection Act, and any rules adopted pursuant thereto".[63]

As drafted, this provision would require a certification of compliance with Sections 619 and 716 of DFA – the "Volcker Rule" and the "Derivatives Push-Out" rule, respectively. Presently, there remain significant open and unanswered questions as to the scope and requirements of Sections 619 and 716. Additionally, the effective dates of these sections of DFA are significantly later than the Proposed Rules currently being considered by the Commission. Further, under the Volcker Rule, the CFTC is expressly mandated to "consult and coordinate" with the other members of the Financial Stability Oversight Counsel "for the purposes of assuring, to the extent possible, that such regulations are comparable and provide for consistent application and implementation of the applicable provisions of this section to avoid providing advantages or imposing disadvantages to the companies affected by this section…." As to the Derivatives Push-Out rule, consultation and consideration are also required among the CFTC, SEC and the applicable Federal Banking Agency.

In light of these significant considerations, we believe that any discussion of the type or nature of certification with respect to these rules, including whether any such certification is feasible or appropriate, should be conducted as part of the Volcker and Derivatives Push-Out rulemaking processes. Consequently, this requirement to certify these provisions should be deleted from the Proposed Rules and the items should be renumbered accordingly.

4) "List any material changes to compliance policies during the coverage period for the report".[64]

We believe that materiality is an important qualifier in this item and that the Annual Report should not describe all conceivable changes to all of the firm's policies and procedures, only those directly related to compliance with the CEA and related CFTC rules.

[61] *See, e.g.,* FINRA Rule 3130.10 (setting forth the required contents of an annual report).
[62] *See, e.g.,* NYSE Rule 342.30.
[63] *See* Proposing Release, 75 Fed. Reg. at 70887 (to be codified at 17 C.F.R. § 3.3(e)(3)).
[64] *See* Proposing Release, 75 Fed. Reg. at 70887 (to be codified at 17 C.F.R. § 3.3(e)(4)).

5) "Describe the financial, managerial, operational, and staffing resources set aside for compliance with respect to the Act and Commission regulations, including any deficiencies in such resources".[65]

The Commission needs to clarify the scope of financial information that is subject to disclosure under this provision (*e.g.*, we do not believe that the firm's budget must be disclosed under this provision. See also our comments below relating to the confidential nature of the Annual Report).

6) "Describe non-compliance issues identified, and the corresponding action taken".[66]

This provision is overly broad as stated in the Proposed Rule and needs to be limited by the materiality standard discussed in item (4), above. It should relate only to the matters covered by the applicable provisions of the DFA and the CEA, not to compliance issues relating to finance, operations, human resources, and other control functions of the firm.

Accordingly, we suggest that the proposed subheading (6) read as follows:

> *"(6) Describe [any material lack of compliance] ~~non-compliance issues~~ [identified with respect to applicable provisions of the Act and related Commission regulations], and the corresponding action taken".*

7) "Delineate the roles and responsibilities of its board of directors or senior officer, relevant board committees, and staff in addressing any conflicts of interest, including any necessary coordination with, or notification of, other entities, including regulators".[67]

Item (7) is troubling because of the time and effort required of each CCO to track and compile all of the requested information. We note that this information is already required by the SEC from public companies under the Sarbanes-Oxley Act.[68] We therefore propose that a public company's filing under Sarbanes-Oxley Act should be sufficient for an entity that is a part of such public company with respect to these items that can be incorporated by reference from the applicable filings under Sarbanes-Oxley Act. Further, we believe that the notion of materiality should be critical in this item as well to limit the scope of information that is subject to disclosure under this subheading.

Accordingly, we suggest that the proposed subheading (7) read as follows:

> *"(7) Delineate the roles and responsibilities of its board of directors or senior officer, relevant board committees, and staff in addressing any [material] conflicts of interest [in respect of the Act and Commission regulations], including any necessary coordination with, or notification of, other entities, including regulators."*

[65] *See* Proposing Release, 75 Fed. Reg. at 70887 (to be codified at 17 C.F.R. § 3.3(e)(5)).
[66] *See* Proposing Release, 75 Fed. Reg. at 70887 (to be codified at 17 C.F.R. § 3.3(e)(6)).
[67] *See* Proposing Release, 75 Fed. Reg. at 70887 (to be codified at 17 C.F.R. § 3.3(e)(7)).
[68] Sarbanes-Oxley Act of 2002, Pub. L. 107-204, 116 Stat. 745 (2002); *see also*, Asset-Backed Securities, 69 Fed. Reg. 26649, 26696 (May 13, 2004).

8) Other Reportable Matters by the CCO under Other CFTC Rules.

We also note that a number of other CFTC's rules recently proposed under the DFA contain references to CCOs, in many different capacities and at different types of institutions. It is a fundamental necessity to reconcile all these rules and to assess the extent of unintended consequences that these rules may have on the existing financial services compliance model and all types of registrants.[69]

For example, the recently proposed CFTC Regulation 23.604 "Requirements for Non-Segregated Collateral" states: "Section 4s(l)(4) of the CEA mandates that, if the counterparty does not choose to require segregation, the SD or MSP shall report to the counterparty, on a quarterly basis, 'that the back office procedures of the swap dealer or major swap participant relating to margin and collateral requirements are in compliance with the agreement of the counterparties.'"[70] This provision is implemented in proposed Section 23.604(a), which requires that such reports be made by the CCO no later than the fifteenth (15th) business day of each calendar quarter for the preceding calendar quarter.

We believe, however, that the quarterly report pursuant to 23.604 should not be subject to the terms of the Proposed Rules and that the Part 3 Annual Report does not need to include a certification to the preceding years. Matters like these need further clarification and coordination.

c. Confidentiality

The Proposed Rules do not state whether the Annual Report will be a public or a confidential document when filed with the CFTC or whether the report may be subject to FOIA[71] disclosure if requested by the public. Indeed, the Commission's FOIA regulations specifically include annual reports as "educational material" which is publicly available and thus subject to public inspection.[72] Because of the possibility that highly confidential and proprietary information may be described in the Annual Report, the Proposed Rules should expressly state that Annual Reports shall be confidential documents that are not subject to public disclosure by listing such Annual Reports as a specifically exempt item in Regulation 145.5.[73]

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[69] *See* Core Principles and Other Requirements for Swap Execution Facilities, 76 Fed. Reg. 1231-35 (proposed Jan. 7, 2011); Governance Requirements for Derivatives Clearing Organizations, Designated Contract Markets, and Swap Execution Facilities, 76 Fed. Reg. 722, 726, 730, 734 (proposed Jan. 6, 2011); Swap Data Repositories, 75 Fed. Reg. 80898, 80912-15 (proposed Dec. 23, 2010); Information Management Requirements for Derivatives Clearing Organizations, 75 Fed. Reg. 78185, 78195 (proposed Dec. 15, 2010); General Regulations and Derivatives Clearing Organizations, 75 Fed. Reg. 77576, 77587-88 (proposed Dec. 13, 2010); Regulations Establishing and Governing the Duties of Swap Dealers and Major Swap Participants, 75 Fed. Reg. 71397, 71406-07 (proposed Nov. 23, 2010); Registration of Foreign Boards of Trade, 75 Fed. Reg. 70974, 70995 (proposed Nov. 19, 2010); Requirements for Derivatives Clearing Organizations, Designated Contract Markets, and Swap Execution Facilities Regarding the Mitigation of Conflicts of Interest, 75 Fed. Reg. 63732, 63721-42 (proposed Oct. 18, 2010); Regulation of Off-Exchange Retail Foreign Exchange Transactions and Intermediaries; Final Rule, 75 Fed. Reg. 55410, 55413, 55447 (Sept. 10, 2010).

[70] Protection of Collateral of Counterparties to Uncleared Swaps; Treatment of Securities in a Portfolio Margining Account in a Commodity Broker Bankruptcy, 75 Fed. Reg. 75432, 75434 (proposed Dec. 3, 2010).

[71] The Freedom of Information Act, 5 U.S.C. § 552.

[72] *See* 17 C.F.R. § 145 app. A.

[73] 17 C.F.R. § 145.5(c).

d. Criminal Liability

We are also concerned with the Commission's statement in the Proposing Release that "[l]iability for false, incomplete, or misleading statements or representations made in the annual report could rest with the registrant or the chief compliance officer or both, either directly or vicariously, and could be administrative, civil, *and/or criminal*." The Proposing Release goes on to say that "*[c]riminal* penalties could be sought by appropriate criminal authorities."[74]

We recognize, of course, that knowingly and willfully making a materially false or misleading statement to the government can, in appropriate circumstances, lead to a civil or even criminal liability,[75] and would never advocate excusing such conduct, but we are concerned by the Commission's specific emphasis on possible criminal sanctions in the context of signing and certifying the Annual Report and making any statement (and particularly incomplete statements or non-material statements) in the Annual Report. Furthermore, specific mention of vicarious and failure to supervise liability may be a further extension of the liability that can potentially be considered criminal.

Accordingly, we believe that it is inappropriate for the Commission to state that CCOs may be subject to specific criminal liability as a result of carrying out their duties and/or signing the Annual Report for the following reasons:

> (1) there is no indication that Congress ever considered the CCOs to be subject to criminal liability under the applicable sections of the DFA;
> (2) criminal liability is not specifically a part of the existing financial services compliance model (either the broker-dealer, CFTC's RFED or banking model);
> (3) potential criminal liability will make it much more difficult, if not impossible, for firms to hire competent employees who will be willing to serve as CCOs; and
> (4) imposition of criminal liability on CCOs with respect to SDs, MSPs and FCMs would create a duplicative, inconsistent, burdensome and unpredictable regulatory environment for many registrants that are subject to and have implemented the existing financial services compliance model.

We note that it does not appear that Congress intended to impose criminal liability on CCOs. This is evidenced by the fact that neither the House nor Senate committee responsible for drafting the applicable DFA provisions consulted with the Congressional Judiciary Committee on this matter. Any provision in proposed legislation that deals with criminal liability must be vetted with the Judiciary Committee. Accordingly, we believe that imposition of criminal liability or even suggesting that CCOs may be subject to criminal liability in discharge of their duties is inappropriate and goes far beyond the statutory mandate of the CFTC.

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[74] Proposing Release, 75 Fed. Reg. at 70884 (emphasis added).

[75] *E.g., see* Title 18, Chapter 47, Fraud and False Statements. "§1001. Statements or entries generally: (a) Except as otherwise provided in this section, whoever, in any matter within the jurisdiction of the executive, legislative, or judicial branch of the Government of the United States, **knowingly and willfully**— (1) falsifies, conceals, or covers up by any trick, scheme, or device a **material** fact; (2) makes any **materially** false, fictitious, or fraudulent statement or representation; or (3) makes or uses any false writing or document knowing the same to contain any materially false, fictitious, or fraudulent statement or entry; shall be fined under this title, imprisoned not more than 5 years…" (Emphasis added.)

Indeed, the reference to criminal liability in the Proposed Rules has led to a significant degree of concern by many of our members. The Associations therefore respectfully request that the Commission carefully clarify the standard for determining when the CCO (or the CEO if, as we recommend, certification responsibility is vested in the CEO) has engaged in conduct that may subject him or her to liability, civil or criminal, and provide guidance with respect to which statutes (especially criminal statutes) may apply. Otherwise, the threat of personal liability, especially criminal liability, for what in hindsight may be adjudged as inappropriate or inadequate job performance, could have extremely negative effects on firms' compliance efforts (*e.g.*, it may become virtually impossible for firms to hire competent employees to perform the duties of CCOs).

Therefore we ask the Commission to clarify that criminal sanctions referenced in the Proposing Release would be sought, if ever, only in circumstances where it has been determined that the CCO has knowingly and willfully made a materially false and misleading statement, and that it is not the Commission's intent to extend criminal liability beyond the existing provisions referenced in footnote 75.

IV. While the DFA Treats FCMs Differently Than SDs and MSPs, the Requirements Can be Harmonized to Work in a Single Regime Based on the Broker-Dealer Model.

Finally, as noted above, although the Proposed Rules are intended to implement requirements of the DFA relating to "the compliance activities of certain registrants,"[76] the DFA takes a markedly different approach in mandating compliance procedures for FCMs than it does for SDs and MSPs. It simply requires each FCM to "designate an individual to serve as its [CCO] 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 [CEA] section 17."

Notwithstanding this flexibility to draft rules tailored to the business and activities of FCMs, or to delegate that responsibility to the NFA (in much the same way that the SEC has let FINRA take the laboring oar in developing a similar structure for broker-dealers), the Commission decided "to apply the same duties and responsibilities to a chief compliance officer of a futures commission merchant as are required for a chief compliance officer of a swap dealer or a major swap participant."[77] While the Associations recognize that there may be advantages for the Commission in creating uniform rules for all types of entities under its jurisdiction, we are concerned that, in so doing, the Commission is ignoring the model for compliance that FCMs have long followed – and the fact that this model is consistent with the practices of many other types of financial institutions.[78]

We understand that certain firms that operate solely as FCMs may be taking the position that the Proposed Rules as currently drafted should not apply to FCMs, and that instead the Commission should propose a separate FCM regime that follows the broker-dealer model. The Associations believe that if the Proposed Rules are modified in the manner that we suggest herein, there would be

[76] Proposing Release, 75 Fed. Reg. at 70881.

[77] Proposing Release, 75 Fed. Reg. at 70881-70882.

[78] *See, e.g.*, FINRA (NASD) Rule 3012; FINRA Rule 3130; Investment Advisers Act Rule, 17 C.F.R. § 270.38a-1; Investment Advisers Act Rule, 17 C.F.R. § 275.206(4)-7; *see also* Regulation of Off-Exchange Transactions and Intermediaries; Final Rule, 75 Fed. Reg. 55410, 55432-49 (Sept. 10, 2010) (to be codified at 17 C.F.R. §§ 5.1-5.25); Securities Exchange Act § 15(b)(4)(E)(i); Basel Committee on Banking Supervision, Compliance and the compliance function in banks (April 2005); Board of Governors of the Federal Reserve System, SR 08-08 / CA 08-11, Compliance Risk Management Programs and Oversight at Large Banking Organizations with Complex Compliance Profiles (October 16, 2010); FDIC Compliance Manual, Compliance Management System 2.1-2.2 (June 2009).

no reason that a unified set of rules, based on the broker-dealer model, could not be applied to FCMs, SDs and MSPs in a manner that is fully in accordance with Congress's goals in adopting DFA Section 731(k).

Indeed, for many integrated firms that are registered as both broker-dealers and FCMs, and in which futures and swaps are part of an integrated securities operation, having compliance procedures that can be applied across businesses and overseen by people performing the same compliance function, would be a far more desirable outcome. However, if the Commission does not modify the Proposed Rules as suggested above, we believe that it must at least modify the rules as they apply to FCMs. Otherwise, FCMs will be required to develop new and different compliance policies for FCMs that diverge from existing, effective practices with respect to the duties and responsibilities of the CCO and the Compliance Department.

V. Cost Estimates.

Finally, the Proposed Rule solicits public comments on the time and cost estimates for the implementation of the Proposed Rule. Even though we have not conducted an exhaustive study on these costs and estimates, and base our conclusion mostly on "back-of-the-envelope" numbers polled from several of our members, we nevertheless believe that the estimate of the costs and time required to comply with the Proposed Rule, set forth in the Proposing Release,[79] is not realistic.

We note that the potential imposition of criminal liability, a high degree of divergence of the Proposed Rules from the existing financial services compliance model and the need for some registrants to completely reorganize their existing compliance systems or implement a duplicative compliance system – will likely impose a very significant cost on the industry.

Given that some, if not most, of the policies and procedures will be drafted by both the in-house lawyers and compliance employees of the registrants, as well as by outside counsel, we assume that the blended rate for each person-hour is roughly $400. Based on this, we believe that the following estimates provide a more realistic assessment:

- Form 8-R and related matters are 10 hours, not 1 hour;
- Preparing, updating and maintaining policies and procedures is 1,000 not 80 hours;
- Preparing the Annual Report is 500 and not 40 hours;
- Annually amending the Annual Report is 50 and not 5 hours; and
- Recordkeeping for compliance policies and procedures and the Annual Report is closer to 500 and not 10 hours.

Thus, we believe that the cost per registrant would be closer to $800,000 and the total to the industry, $350 million and not $6.2 million as originally estimated by the CFTC.

VI. Conclusion

As explained above, the Proposed Rules would establish a compliance framework that is significantly different from that currently in place in the financial services industry under the regulations promulgated by other Federal regulators, including the SEC and the several banking regulators, as well as the compliance model adopted by the Commission itself as recently as

[79] *See* Proposing Release, 75 Fed. Reg. at 70885-86.

September 2010. Further, the CFTC has published other rules for comments under the DFA that would impose additional obligations on CCOs. In light of the Associations' extensive comments on the Proposed Rules, and in order to afford commenters the opportunity to assess adequately all of the obligations that the CFTC has proposed to impose on the CCOs, the Associations respectfully request that the Commission publish for an additional short comment period any revisions that it may make to the Proposed Rules and any other proposed rules that may impose obligations on CCOs.

In conclusion, while the Associations support the Commission's efforts to provide a strong framework for the compliance activities of FCMs, SDs, and MSPs, we believe that the rules currently proposed by the CFTC to implement Sections 731(k) and 732(d) of the DFA go well beyond the mandate laid out in the DFA, and in some ways the language of the Proposed Rules appear to misconstrue the provisions and the intent of these sections. Most importantly, the Proposed Rules, as currently drafted, are not consistent with the established compliance models applicable to financial services firms in the U.S.

Specifically, we believe that: (i) the CCO should not be considered a supervisor of the registrant; (ii) the CEO, not the CCO, should be certifying the accuracy and completeness of the Annual Report; (iii) no certifying officer, including the CEO and/or CCO should be subject to specific personal criminal liability in the CCO requirements context; (iv) the Annual Report should be confidential and not subject to FOIA disclosure; (v) the CFTC should clarify that the CCO need not "ensure" compliance in the sense of "guarantee", but to mean – ensure compliance by putting in place policies and procedures reasonably designed to achieve compliance under the Act and the Commission regulations; (vi) the term "resolve" conflicts of interest should mean for the CCO to cooperate with the registrant's top management and the board to achieve resolution of these conflicts; (vii) the CFTC should not mandate certification of compliance with Sections 619 and 716 of the DFA in the Annual Report; (viii) the FCMs should not be subject to the Proposed Rules unless the CFTC accepts our proposed revisions, and alternatively, FCMs' CCOs should be subject to the NFA rules promulgated under the DFA; and finally, (ix) the CFTC should consider adopting the existing financial services model as its guide in promulgating the CCO rules under the DFA.

The Associations appreciate the opportunity to submit these comments regarding the CFTC's rulemaking on the CCOs for SDs, MSPs and FCMs.

Sincerely,

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Kenneth E. Bentsen, Jr.
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cc: Honorable Gary Gensler, Chairman
Honorable Michael Dunn, Commissioner
Honorable Jill E. Sommers, Commissioner
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