WMBA
AMERICAS
WHOLESALE MARKETS BROKERS' ASSOCIATION

March 8, 2011

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

Re: Core Principles and Other Requirements for Swap Execution Facilities (RIN 3038–AD18)

Dear Mr. Stawick:

The Wholesale Markets Brokers' Association, Americas ("WMBAA") is an independent industry body representing the largest interdealer brokers operating in the North American wholesale markets across a broad range of financial products.[1] The WMBAA seeks to work with Congress, regulators and key public policymakers on the regulation and oversight of the over-the-counter ("OTC") derivatives markets and their participants. By working with regulators to make OTC markets more efficient, robust and transparent, the WMBAA seeks to assist in the monitoring and consequent reduction of systemic risk in the country's capital markets.

The WMBAA is submitting this comment on the Commission's Notice of Proposed Rulemaking on Core Principles and Other Requirements for Swap Execution Facilities ("SEFs").[2] Members of WMBAA already provide SEF-like services in the OTC derivatives markets, and intend to form SEFs when the Commodity Exchange Act, as amended by the Dodd-Frank Act (collectively, the "Act") becomes effective and the implementing rules are finalized. The members of WMBAA therefore have a vital interest in the proposed regulations for SEFs that have been issued by the Commission. This comment addresses proposed regulations relating to Core Principle 15 – Designation of Chief Compliance Officer, namely Proposed Regs. 37.1500 and 37.1501 (the "Proposed Rules").

Introduction

WMBAA shares the Commission's objective that each SEF have a robust and effective compliance program. Moreover, the members of WMBAA have substantial experience in implementing compliance programs for broker-dealers and futures commission merchants. This experience will be instructive in designing and establishing compliance programs for SEFs. WMBAA's comments on the Proposed Rules seek to provide the Commission with the benefit of the WMBAA members' past experiences with compliance programs to assist the Commission in establishing an effective compliance function that is appropriate for SEFs and satisfies the requirements of the Act.

[1] The members of WMBA are BGC Partners, GFI Group Inc., ICAP plc, Tradition (North America) Inc., and Tullett Prebon Ltd.

[2] 76 Fed. Reg. 1214 (Jan. 7, 2011).

Although well intended, the Proposed Rules are impractical and unworkable, and distort the proper role of a Chief Compliance Officer ("CCO"). They mandate a compliance structure which has the potential to disregard and undermine the accountability of corporate management for compliance, by blurring the respective roles of the CCO and CEO, suggesting that management does not have the primary responsibility for a SEF's compliance. Instead of strengthening compliance by underscoring management's responsibility for compliance, the Proposed Rules seek to place the responsibility for compliance on the CCO. But the CCO, who is an advisor and administrator of compliance procedures, lacks the corporate authority to fulfill this responsibility.

The Commission should discard the flawed compliance structure in the Proposed Rules. Instead, the Commission should permit SEFs to structure their compliance programs in accordance with established regulatory models, where management and the board of directors are responsible and accountable for compliance, with the CCO role being to recommend, establish and administer procedures to assist them in fulfilling their responsibilities.

Comment

1. There is an Established and Appropriate Role for a Chief Compliance Officer

The role of a CCO has developed consistently in the regulated futures, securities and banking industries, as well as in corporate organizations generally. As a result, CCOs in these different businesses have similar functions and responsibilities that provide an established model which should guide the Commission in defining the duties of a SEF's CCO.

a. The Role of a CCO in the Futures Industry

In the futures industry, the role of a CCO has not until recently been defined by statute or regulation. Rather, registered firms have themselves defined the job. In general, they have viewed compliance as the responsibility of management, and have appointed CCOs and other compliance personnel to support management in carrying out this important responsibility. The traditional function of a compliance department, headed by a CCO, has been to recommend, establish and maintain compliance programs designed to educate employees regarding compliance, to detect compliance problems within the firm, and to advise management how to satisfy their compliance responsibilities.

A CCO in the futures industry has often been an attorney or has reported to the firm's General Counsel, because the CCO has complemented the General Counsel's role in a registered firm. Both the CCO and the General Counsel have typically acted as advisors to management with independence from the firm's business operations. Neither has been responsible for the supervisory function, which has been exercised by management and supervisors appointed by management.

Consistent with this model, the CFTC recently adopted Rule 5.18(j) establishing a requirement for each retail foreign exchange dealer to designate a chief compliance officer.[3] Significantly the new rule only requires that the CCO (i) certify to the Commission and a registered national futures

[3] See 75 Fed. Reg. 55409 (September 10, 2010).

association annually that the retail forex counterparty has in place processes to establish, maintain, review, modify and test policies and procedures reasonably designed to achieve compliance with the Act, rules, regulations and orders thereunder, and (ii) apprise the chief executive officer of the compliance efforts to date and identify and address significant compliance problems and plans to address those problems.

Currently the only other formal requirement for a CCO in the futures industry is in National Futures Association ("NFA") Compliance Rule 2-36(j), which requires a Forex Dealer Member ("FDM") of NFA to designate a CCO. This CCO requirement is fully consistent with the traditional role for a CCO, which is to administer compliance policies, procedures and surveillance programs, and to advise senior management on compliance problems and potential solutions to these problems. Under the applicable NFA rule, the CCO of an FDM must be designated as a principal of the firm, which means that the CCO must satisfy fitness standards applicable to principals. In addition, the CCO must certify annually to NFA that the FDM has a process in place to establish, maintain, review, modify and test policies and procedures that are reasonably designed to achieve compliance with the Commodity Exchange Act, CFTC Regulations and NFA requirements. Each CCO must also certify that the FDM has compliance processes in place and that the CCO has apprised the FDM's chief executive officer or equivalent management of the FDM's compliance efforts to date, any significant compliance problems, and the CCO's plan to address those problems.

Supervision is not included as a compliance function for FDMs, but rather is the responsibility of the firm's registered persons.[4] Under the NFA's futures registration requirements, all individuals involved in sales or supervision of sales are required to be registered as associated persons ("APs").[5] It is the APs, and not the CCO, who have the duty to supervise.[6] This is a reasonable and customary division of responsibility, because it is the APs, and not compliance personnel, who have the right to hire, fire and discipline employees involved in regulated activities.

b. The Rule of a CCO in the Securities Industry

FINRA guidance for its members has established a similar role for the CCO. Under FINRA Rule 3130(a), each FINRA member must designate one or more principals as CCO. The Supplementary Material for this rule, at para. .05, explains the role of a CCO for a FINRA member as being "a primary advisor to the member on its overall compliance scheme and the particularized rules, policies and procedures that the member adopts." According to FINRA, a CCO should have 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

[4] NFA Compliance Rule 2-36(e).

[5] CFTC Reg. 1.3 (aa)(1).

[6] CFTC Reg. 166.3.

compliance policies; and (5) developing programs to test compliance with the member's policies and procedures.

c. The Compliance Function in the Banking Industry

Compliance in the regulated banking industry has followed a similar pattern. In its April 2005 publication, entitled "Compliance and the compliance function in banks," the Basel Committee on Banking Supervision issued standards for the compliance function in banks. Under these standards, senior management is responsible for the effective management of the bank's compliance risk, and the board of directors is responsible for overseeing this effort by management. Under the Basel standards, the compliance function should be independent. That independence includes a structure where the head of compliance does not have business line responsibilities, and the compliance department's function is to assist management in managing the bank's compliance risk. The compliance department's specific responsibilities under the Basel standards include providing advice to management and education and guidance to employees, conducting identification, measurement and assessment of compliance risk, engaging in monitoring, testing and reporting activities, performing statutory roles such as anti-money laundering compliance officer, acting as a liaison with regulators, and administering compliance programs. The Board of Governors of the Federal Reserve System has stated that its expectations for bank compliance functions are consistent with the Basel standards.[7]

d. Corporate Accountability and the Role of a CCO

General principles of corporate accountability are consistent with the traditional role of compliance department. Under these principles, directors are ultimately responsible for compliance, but may rely on a well-structured compliance department to satisfy this responsibility. In its 1996 Caremark decision, the Delaware Court of Chancery stated that a corporate director's duty of good faith includes a duty to be informed by exercising good faith judgment that the corporation's information and reporting system is adequate, and that failure to attempt to insure that such a system exists will establish the lack of good faith necessary for personal liability for corporate wrongdoing.[8] More recently, in Stone v. Ritter, the Delaware Supreme Court approved and applied this statement from Caremark by ruling that individual directors were not personally liable for the misconduct of employees where they had established an adequate compliance program.[9]

Similarly, the Federal Sentencing Guidelines for Organizations, which provide guidance for the severity of punishment in cases where business organizations are criminally liable, take into account the organization's due diligence with respect to the organization's compliance function. In order to show due diligence, the organization's governing authority must be knowledgeable about the content and operation of the compliance program and must exercise reasonable oversight with respect to the implementation and effectiveness of the program. Individuals with operational responsibility for the compliance program should report periodically to high-level personnel and, as appropriate, to the governing authority, or an appropriate subgroup of the governing authority, on the effectiveness of

[7] SR 08-8/CA 08-11 (October 16, 2008).

[8] *In re Caremark Int'l Inc. Deriv. Litig.* 698 A. 2d 959 (Del. Ch. 1996).

[9] 911 A.2d 362 (Del. 2006).

the compliance program. Moreover, the compliance personnel should be given adequate resources, appropriate authority, and direct access to the governing authority or an appropriate subgroup of the governing authority.

e. The Commission's Proposal for the Compliance Function of a Designated Contract Market

The Commission's advance notice of proposed rulemaking relating to core principles for designated contract markets ("DCMs") provides for a compliance department which performs the traditional role.[10] Proposed Reg. 38.155 in that notice contains the requirements for the compliance staff of a DCM. This proposed regulation provides that a DCM must establish and maintain sufficient compliance department resources and staff to ensure that it can conduct effective audit trail reviews, trade practice surveillance, market surveillance, and real-time market monitoring. The DCM's compliance staff must also be sufficient to address unusual market or trading events as they arise, and to conduct and complete investigations in a timely manner.

f. Value of the Traditional Role of a CCO

The traditional division of responsibilities between management and compliance in the futures, securities, banking and other industries has served valuable objectives. Management is responsible for compliance, but it also has the authority to enforce compliance, including the authority to hire, direct, supervise and fire employees. Management can therefore reasonably be held accountable if there is a compliance problem. At the same time, the CCO has a defined role which includes detecting problems, advising management and administering compliance programs, but does not include responsibility for the firm being in compliance with the law.

The Act does not require a departure from the traditional division of responsibility between management and the compliance department. Under the Act, the CCO must report either to the senior officer or the board of directors, but the Act does not require the CCO to exercise the authority of the board or management. The Act also requires the CCO to review the SEF's compliance with core principles, to consult with the board or senior officer to resolve conflicts of interest, to establish and administer policies and procedures, and to establish procedures for remediation. All of these statutory requirements are consistent with the traditional structure, and allow the board and management to continue to perform their traditional functions.

The statutory requirement that the CCO "ensure compliance" with the Act and rules and regulations issued under the Act does not require the CCO to become responsible for management of the SEF. This same language is used in section 4s(k)(2)(E) of the Act for CCOs of swap dealers, yet the Commission has stated in its release regarding CCOs of swap dealers: "The chief compliance officer can only ensure the registrant's compliance to the full capacity of an individual person, and the duties of the chief compliance officer do not elevate the position above the board of directors, or otherwise contradict basic and well-established tenets of law regarding the allocation of responsibility within a business association."[11] Thus the Commission has recognized that the

[10] 75 Fed. Reg. 80572 (December 22, 2010).

[11] 75 Fed. Reg. 70881, 70883 (November 19, 2010).

language in the Act which requires a CCO to "ensure compliance" can be construed consistently with the traditional role of a CCO. This construction, moreover, is the only reasonable construction of the requirement that a CCO ensure compliance, because the CCO does not have the authority to ensure compliance other than performing the traditional role.

In summary, there has in the past been a clear division of authority between the roles of management and the compliance department, with management having the responsibility for compliance, and the compliance department acting in a supporting role. This division of responsibility has been recognized by the Commission, the SEC, the NFA, the banking regulators, the Department of Justice and the courts. In contrast, the structure which the Commission is proposing in the Proposed Rules, which would shift management's responsibility to the CCO, has no recognized precedent.

2. The Proposed Rules Should be Revised

The Proposed Rules disregard the sound division of authority that has existed in the past between management and compliance. If the Proposed Rules were approved, the result would be that it would be unclear whether management remains responsible and accountable for compliance. At the same time, the CCO would be placed in the untenable position of being responsible and accountable for the organization's compliance with the law, without the requisite corporate authority needed to enforce this compliance.

a. The CCO for a SEF Should be an Advisor to Management and Administrator of Compliance Programs

Instead of giving the CCO the traditional role of an advisor to management and administrator of compliance programs, the Proposed Rules make the CCO directly responsible for the SEF's compliance with the law. For example, Proposed Reg. 37.1501(b)(1)(i) says that the CCO position shall carry with it the authority and resources to enforce the policies and procedures, and that the CCO shall have supervisory authority over all staff acting in furtherance of the CCO's obligations. This change in the traditional role of a CCO would undermine the authority of senior management and the board to enforce compliance, and would change the role of a compliance officer from advisor and administrator to a line manager. The Commission should not adopt this flawed proposal.

In addition, the Proposed Rules require that the CCO supervise the SEF's self-regulatory program and any third party service providers of compliance services. These, however, should be management functions. These programs can be designed and administered by the CCO, but management should be ultimately responsible for supervision of both the SEF's self-regulatory program and the outsourcing of compliance services. The Commission should therefore not adopt this proposal.

b. The CCO Should be Permitted to be a Member of the SEF's Legal Department

Under the Proposed Rules, the CCO may not be the General Counsel or even a member of the legal department. This prohibition is not required by the Act, and there is no valid regulatory reason for it. Under current industry practice, it is not uncommon for a CCO to be the General Counsel or to

report to the General Counsel. Moreover, the roles of General Counsel and CCO are complementary, as both serve as advisors to management. It is important for both the legal department and compliance department to have independence from sales and other management functions. This independence, however, can be achieved by including both in the legal department, and there is no regulatory benefit to prohibiting this practice.

c. Reporting Relationships of the CCO Should Be Flexible

There are provisions in the Proposed Rules requiring that the CCO be appointed by the board and that the CCO's compensation be fixed by the board, but permitting in the alternative that the senior officer may fulfill these responsibilities. Both alternatives go beyond the Act, which merely requires that the CCO report directly to the board or senior officer. Similarly, permitting removal of the CCO only by a majority of the board, as provided in the Proposed Rules, is not required by the Act. SEFs should have the flexibility for CCOs to have multiple reports within the organization and to have their compensation determined as the SEF's management deems proper in its business judgment. As long as the CCO has a direct line of communication with the board or senior officer, the requirements of the Act will be satisfied.

Furthermore, the CCO should be permitted to satisfy the statutory requirement of reporting to the board or senior officer by reporting to a regulatory oversight committee composed of board members. The Commission has issued Proposed Reg. 37.19, which would require that such a committee be established.[12] As long as this reporting relationship is in place, the management of the SEF should be permitted to structure the day to day reporting relationships of the CCO in accordance with its reasonable business judgment.

By requiring the CCO's annual report to be submitted to the Commission without any changes by the board or senior officer, the Proposed Rules undermine the authority of the board and management. This prohibition on changes by the board or senior officer is not required by the Act. Moreover, it would interfere with management's authority to make decisions regarding compliance, and thus could make it unfair to hold them accountable for compliance failures. The board or management should be the ones to make the business decisions regarding compliance, and they can then be fairly held accountable for those decisions. The Commission should therefore not adopt this proposal.

d. The Rules Should Encourage Qualified Persons to Become CCOs

Finally, as a practical matter, the Proposed Rules would make it difficult to find a qualified individual to perform the CCO position for a SEF. Under the Proposed Rules, the CCO would have no clear management authority, but would have responsibility and potential personal liability for compliance problems. This is an untenable position for the CCO, and would discourage qualified persons from serving in that role. The Commission should not place a CCO in this position, and should therefore not adopt this proposal.

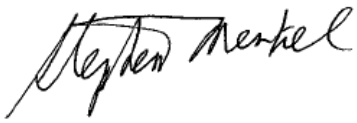
[12] 75 Fed. Reg. 63732 (October 18, 2010); 76 Fed. Reg. 722 (January 6, 2011).

Conclusion

WMBAA requests that the Commission reconsider and withdraw the Proposed Rules, and instead issue final rules which reflect the traditional allocation of responsibilities among the board, management and compliance department. The final rules should recognize that management, subject to board oversight, is responsible for compliance, while the CCO's role is to advise management and to develop, administer and monitor compliance procedures. Such final rules would be fully consistent with the Act, and would be the most effective way to promote compliance within SEFs.

WMBAA appreciates the opportunity to submit this comment, and would be pleased to provide additional information to assist the Commission in arriving at final CCO rules which will achieve the valid regulatory purposes of the Act while permitting SEFs to structure their compliance programs in the most effective manner.

Very truly yours,



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