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Mr. David A. Stawick
Secretary
Commodity Futures Trading Commission
1155 21st Street, N.W.
Washington, D.C. 20581

14 January 2013

Re: Enhancing Protections Afforded Customers and Customer Funds Held by Futures Commission Merchants and Derivatives Clearing Organizations: Proposed Rule (RIN 3038-AD88)

Dear Mr. Stawick:

Ernst & Young LLP is pleased to comment on the rule the Commodity Futures Trading Commission (CFTC or Commission) proposed on *Enhancing Protections Afforded Customers and Customer Funds Held by Futures Commission Merchants and Derivatives Clearing Organizations* (Proposed Rule).

We support the CFTC's objectives of improving customer protection and disclosures, strengthening risk management programs and enhancing the oversight and examination of futures commission merchants (FCMs) and derivatives clearing organizations. However, we have outlined below our concerns about specific aspects of the Proposed Rule related to the oversight and examination of FCMs.

§1.16 Qualifications and reports of accountants

1. *Qualifications of accountants*

   The Proposed Rule includes amendments that "a certified public accountant engaged to conduct an examination of a futures commission merchant must be registered with the Public Company Accounting Oversight Board, have undergone an examination by the Public Company Accounting Oversight Board, and any such deficiencies noted during such examination must have been remediated to the satisfaction of the Public Company Accounting Oversight Board within three years of such report."[1]

   We have concerns about two aspects of this proposal.

   First, the Proposed Rule would require that an auditor of an FCM must be registered with the Public Company Accounting Oversight Board (PCAOB or Board) and have undergone an "examination" by the PCAOB. We assume that the word "examination" is intended to refer to inspections that the PCAOB performs according to requirements of Section 104 of the Sarbanes-Oxley Act. We question the need for such an inspection requirement. Among other things, it would

[1] Page 67937, Section 7 (b) (1) of §1.16 in the Proposed Rule.

mean that newly registered firms would be unable to audit FCMs because they have not yet been inspected by the PCAOB. Moreover, the proposed requirement could give a misleading impression that FCM audit engagements are subject to PCAOB inspection.

Second, and more significantly, the reference to satisfactory remediation "within three years" of the issuance of a PCAOB report would be unworkable. Pursuant to Section 104(g)(2) of the Sarbanes-Oxley Act, the PCAOB issues a non-public report on an inspected firm's quality control systems; that report is not made public if criticisms or defects in those systems are addressed by the firm "to the satisfaction of the Board, not later than 12 months after the date of the inspection report." If the Board is not satisfied with a firm's remediation, the portion of the inspection report dealing with the unremediated defect is made public. However, the PCAOB does not later formally inform the firm that the defects identified in the report have in fact been remediated successfully. While it may be inferred that a previously mentioned defect has been corrected to the PCAOB's satisfaction if that defect is omitted in subsequent year inspection reports, this would be a supposition on the firm's part.

For these reasons, we suggest the CFTC adopt another approach.

One approach that may achieve the CFTC's objectives would be to seek a statutory change to make auditors of non-issuer FCMs subject to the registration and inspection requirements of Sarbanes-Oxley, just as Congress, in Section 982 of the Dodd-Frank Act, provided the PCAOB with oversight of non-issuer broker-dealers. Because FCMs may be dually registered as broker-dealers, a common regulatory framework for the auditors of FCMs and broker-dealers would make sense. Of course, we recognize that seeking legislative changes would be an arduous process with unpredictable outcomes.

Alternatively, the Securities and Exchange Commission (SEC) has adopted Rule 206(4)-2(a)(6)(i) to require that accounting firms performing surprise examinations of investment advisers holding custody of client funds must be "registered with, and subject to regular inspection by, the PCAOB." [2] PCAOB inspections will not cover audit work performed on most FCMs, since, like investment advisers, most FCMs are not issuers, but an accounting firm registration/inspection requirement might lead to greater confidence in the overall quality of the independent audit firm. If the CFTC were to go down this path, it should explain the rationale and not leave any misimpression that audits of FCMs would be subject to PCAOB inspection.

2. *Representations as to the audit*

The Proposed Rule would require the accountant's report to "state whether the audit was made in accordance with US generally accepted auditing standards after full consideration to the auditing standards adopted by the Public Accounting Oversight Board, and must designate any auditing procedures deemed necessary by the accountant under the circumstances of the particular case which have been omitted and the reasons for their omission."[3]

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[2] SEC Release No. IA-2968; File No. S7-09-09, Custody of Funds or Securities of Clients by Investment Advisers

[3] Page 67937, Section 7 (c)(2) of the Proposed Rule.

We are unaware of any existing reporting framework that requires the application of one set of standards (e.g., US GAAS) and the "consideration" of another set of standards (e.g., PCAOB auditing standards). It is also unclear what is meant by the phrase "full consideration" of PCAOB auditing standards: Does it mean the PCAOB auditing standards would apply, and, if so, how? We believe that significant confusion would result under this approach, and we recommend that the CFTC select a single set of auditing standards appropriate for audits of FCMs.

As noted earlier, FCMs may be dually registered as broker-dealers. Under the proposed amendments to SEC Rule 17a-5, all broker-dealer audits would be required to be performed in accordance with PCAOB auditing standards. Therefore, we recommend that the CFTC align the auditing standards for audits of FCMs with those for audits of broker-dealers, ensuring a single set of standards for audits of all FCMs.

If the CFTC does require audits of FCMs to be executed in accordance with PCAOB auditing standards, clarification will be needed about which auditing standards will apply. We believe certain elements of the PCAOB auditing standards would not apply in the context of an audit of an FCM (e.g., Auditing Standard No. 5, *An Audit of Internal Control over Financial Reporting that is Integrated with an Audit of Financial Statements*).

We also request that the CFTC omit the requirement that the accountant's report "...must designate any auditing procedures deemed necessary by the accountant under the circumstances of the particular case which have been omitted and the reasons for their omission." Auditors are required to obtain sufficient competent evidential matter to afford a reasonable basis for an opinion regarding the financial statements under audit. If a restriction on the scope of an audit is imposed by the client or results from other circumstances, both the American Institute of Certified Public Accountants (AICPA) and PCAOB auditing standards currently provide factors for the auditor to consider in deciding whether to qualify or disclaim an opinion because of a limitation on the scope of the audit, and the standards provide examples of the form of report.[4]

§1.52 Self-regulatory organization adoption and surveillance of minimum financial requirements

1. *Examinations expert*

The Proposed Rule would require that each Self-Regulatory Organization (SRO) supervisory program of its member FCMs be reviewed by an "examinations expert." The term "examinations expert" is defined under proposed changes to Rule 1.52(a) as "a Nationally recognized accounting and auditing firm with substantial expertise in audits of futures commission merchants, risk assessment and internal control reviews, and is an accounting and auditing firm that is acceptable to the Commission."

The proposed review may fall outside of the expertise of the accounting profession; auditors likely would not be able to perform certain of the proposed responsibilities of the examinations expert (such as providing sales practice, compliance, operational or regulatory recommendations) under current attestation standards. We also are concerned that several elements of the Proposed Rule

[4] AU-C 700.11-.14 and AU 508.22-.34.

related to this requirement are not supported under any current reporting framework, such that implementation of those elements will not be practicable. It is unclear what criteria the programs would be measured against, and under what framework the examinations expert would opine.

Therefore, the CFTC should reconsider how the objectives of this aspect of the Proposed Rule can be accomplished by other means.

Conclusion

In summary, we support the objectives of the Proposed Rule; however, we encourage the Commission to consider the observations and concerns related to the elements of the Proposed Rule discussed above.

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We would be pleased to discuss our comments with the Commission or its staff at your convenience.

Very truly yours,

Ernst & Young LLP