



September 4, 2018

Mr. Christopher J. Kirkpatrick
Secretary of the Commission
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street NW
Washington, DC 20581

Re: RIN 3039—AE73 – Proposed Rule Financial Surveillance Examination
Program Requirements for Self-Regulatory Organizations

Dear Mr. Kirkpatrick:

NFA appreciates the opportunity to comment on the Commission's proposal to amend its regulations governing the minimum standards for self-regulatory organization's (SRO) financial surveillance examination program of futures commission merchants (FCMs) (i.e., Regulation 1.52). The proposal includes two key amendments—revising the scope of the third party examinations expert's evaluation of the SRO financial program and revising the minimum timeframes between when an SRO must engage the examinations expert to evaluate the FCM examination standards. For the reasons discussed below, NFA supports both these changes.

As noted in the *Federal Register* release, the Commission adopted a number of new rules and rule amendments to enhance customer protections in 2013. Among other things, the new regulations require SROs to modify the FCM examination program to conform to the auditing standards issued by the Public Accounting Oversight Board (PCAOB) as such standards would be applicable to a non-financial audit and to engage an examinations expert to perform an initial evaluation of the supervisory program and also to evaluate the SRO's application of the program once every three years after its initial use.

NFA and CME, working with an entity that would qualify as an examinations expert, developed a set of examination standards that conformed to the PCAOB standards that are applicable to a non-financial audit (FCM examination standards). By letter dated October 1, 2015, Commission staff indicated that NFA and CME could use these standards to develop the FCM supervisory program required by Regulation 1.52. Thereafter, NFA and CME updated the FCM supervisory program and engaged an examinations expert to conduct the initial review of the FCM supervisory program. In March 2016, the examinations expert issued a report, which determined that the FCM supervisory program addressed the FCM examination standards.

NFA fully supports CFTC Regulation 1.52's regulatory objective of strengthening and enhancing the FCM supervisory program in order to minimize the chances that an FCM engages in unlawful activities that result in the loss of customer funds or the inability of an FCM to meet its financial obligations. NFA believes that the changes that NFA and CME made to the FCM supervisory program to conform to the newly developed FCM examination standards have enhanced the program. However, we do not believe that there is a significant regulatory benefit to engaging an examinations expert every three years to conduct a review of our application of the program. Moreover, we believe that the current scope of the review goes beyond the expertise of the examinations expert. We respectfully offer the following comments on the Commission's proposed changes.

Scope of the Review

NFA fully supports the Commission's proposal to modify the scope of the examinations expert's review. Currently, Commission Regulation 1.52 requires that the examinations expert evaluate, comment and make recommendations to the SROs on their application of the supervisory program. NFA agrees with Commission staff's assessment noted in the *Federal Register* that "Commission staff has the expertise in the application of CFTC regulations to operations of FCMs, and is appropriately situated to assess whether [NFA and CME] are accurately and properly applying Commission requirements to FCMs in their execution of the examination programs."¹ Moreover, NFA believes that the thorough rule enforcement reviews (RER) regularly performed by Commission staff are similar in nature to the examinations expert's review and provide effective and meaningful oversight of the FCM supervisory program. As part of an RER, Commission staff review the FCM examination program and the application of the program and provide a report that makes recommendations on changes to the program itself or the manner it was implemented.

Given Commission staff's expertise, NFA believes it is appropriate to limit the examinations expert's review to evaluating the examination standards for consistency with any new or amended auditing standards issued by PCAOB since the time of the last examinations expert's review. NFA fully agrees that this is the area in which the examinations expert can provide meaningful input on ways to enhance the FCM supervisory program.

Minimum Time Frame between Reviews

The Commission's proposed rule also modifies the time frame between the mandatory examinations expert's reviews. Under the current rule, NFA and CME must engage an examinations expert at least once every three years to conduct a

¹ See *Financial Surveillance Examination Program Requirements for Self-Regulatory Organizations*, 83 FR 31078 (July 3, 2018) at 31081.

review. The Commission's proposed amendment moves away from this three year time frame and requires NFA and CME to review and revise the FCM examination standards promptly after the issuance of any new or amended PCAOB standards that have an impact on the FCM examination standards. In this case, NFA and CME would be required to engage an examinations expert to evaluate the consistency of the revised FCM examination standards with the PCAOB auditing standards. The proposed amendments also provide the Director of the Division of Swap Dealer and Intermediary Oversight (DSIO) with the authority to direct NFA and CME to engage an examinations expert. The Director's authority appears to be for cases in which DSIO staff believe that a new or amended PCAOB standard has a material impact on the FCM examination standards but NFA and CME have not engaged an examinations for a prompt review. Finally, the proposed rule requires that NFA and CME engage an examinations expert at least once every five years to address time periods where NFA and CME have not considered any new or amended PCAOB standards to be material to the FCM examination program.

NFA generally agrees with the proposed review approach and believes it is a significant improvement over the current set three year time period. PCAOB standards are not adopted or amended on a regular basis, and even when new standards are adopted or existing standards are amended, those changes may not have any impact on the FCM examination standards. In fact, since the FCM examination standards were adopted in 2015, the Securities and Exchange Commission (SEC) has only approved two amendments to the PCAOB standards and neither of those amendments applied to the FCM examination standards.² Given the infrequency of new or amended PCAOB standards, and the fact that not all new or amended standards will impact the FCM examination standards, it is likely that there would not be any material changes to review on a three year cycle if the Commission were to amend Rule 1.52 to limit the scope of review to the PCAOB standards alone.

While NFA supports extending the time period between mandatory reviews from three to five years, NFA requests that the Commission consider if there is a need at all for any set time period between reviews or, alternatively, providing the Director of DSIO with the authority to provide the SROs with relief from engaging the examinations expert at the end of a five year time frame. As explained above, NFA and CME are under an affirmative obligation to review new or amended PCAOB standards, make appropriate changes to the FCM examination standards, and engage an examinations expert to review these changes. Additionally, if NFA and CME do not meet this obligation, then the Director of DSIO can direct NFA and CME to do so. NFA envisions that the only situation in which we would have to engage an examinations expert once every five years is if there are no changes to the PCAOB standards that impact the FCM standards. In that event, NFA and CME would be required to engage

² Similarly, for the two years just prior to the adoption of the FCM examination standards, there were five amendments/new standards, of which only one applied to the FCM examination standards.

an examinations expert simply to conclude that no changes were necessary. This type of review seems unduly burdensome and costly, particularly since NFA, CME and Commission staff are sufficiently knowledgeable to determine within the five year period if any new or amended PCAOB standards impact the FCM examination standards.

NFA believes that a reasonable solution to this issue may be for the Commission to amend Regulation 1.52 to eliminate the set time period or specify that the Director of DSIO has the authority to provide the SROs with relief from engaging the examinations expert at the end of a five year time frame. This would address situations where the Director agrees that there have not been any changes to the PCAOB standards that impact the FCM examination program and therefore there is no need for an examinations expert's review.

Other Comments and Conclusion

NFA believes that the proposed changes will make the examinations expert's reviews significantly more efficient by focusing on areas of the examinations expert's expertise and less costly by reducing the scope and frequency of the reviews. NFA fully agrees with the Commission's assessment noted in the *Federal Register* that "engaging an independent third party to review the entire program involves additional cost, but results in only a small incremental benefit."³

More importantly, NFA does not believe that the changes will in any way diminish customer protection given that Commission staff will continue to conduct similar reviews and the examinations expert will still review any changes to the FCM examination standards based on changes to PCAOB standards. NFA also notes that NFA and CME adopted other requirements several years ago that have significantly strengthened customer protection, which are not in any way impacted by this proposal. In particular, NFA and CME working with Commission staff implemented a daily confirmation system that allows NFA and CME to obtain confirmation of the balances in all customer segregated accounts directly from the depositories holding those funds. Additionally, NFA working with the CME and Commission staff adopted Financial Requirements Section 16, which governs an FCM's practices involving its residual interest in customer segregated funds, including the requirement that the firm notify NFA in the event that it transfers or disburses funds from a customer segregated account not for the benefit of a customer that exceeds 25% of the FCM's residual interest in that account. NFA believes that all these requirements, working together, provide a solid foundation for the protection of customer funds and oversight of FCM financial requirements.

³ 83 FR 31078 at 31081.

Christopher J. Kirkpatrick

September 4, 2018

If you have any questions concerning this letter, please do not hesitate to contact me at 312-781-1409 or cwooding@nfa.futures.org or Regina G. Thoele at 312-781-1327 or rthoele@nfa.futures.org

Very truly yours,



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(caw: Comment Letters-Financial Surveillance Examination Program)