

May 11, 2017

## CFTC Proposes to Amend CCO Rules

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### CFTC Proposes Amendments to Chief Compliance Officer Duties and Annual Reports

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#### SUMMARY

On May 3, 2017, the Commodity Futures Trading Commission (the “CFTC”) announced proposed amendments to its rules governing the duties of chief compliance officers (“CCOs”) of registered swap dealers (“SDs”), major swap participants (“MSPs”) and futures commission merchants (“FCMs”) (collectively, “Registrants”) and to the content and delivery requirements of the annual compliance report (the “Annual Report”) required to be filed by each Registrant under Regulation 3.3(e) of the CFTC’s regulations (the “CFTC Regulations”) implementing the Commodity Exchange Act, as amended (the “CEA”).<sup>1</sup> The proposed changes include:

- defining the term “senior officer,” in order to clarify the CCO’s supervisory reporting line;
- clarifying the scope of the CCO’s role in administering compliance procedures and resolving compliance issues;
- eliminating the requirement that the Annual Report describe the Registrant’s policies and procedures with respect to each applicable requirement under the CEA and CFTC Regulations; and
- requiring the CCO to deliver the Annual Report to the audit committee, board of directors and senior officer prior to furnishing it to the CFTC.

Comments on the proposed amendments are due on or before Friday, July 7, 2017.

## I. BACKGROUND

The Dodd-Frank Wall Street Reform and Consumer Protection Act amended the CEA to, among other things, require each Registrant to designate a CCO, with specified compliance responsibilities with respect to the Registrant's businesses subject to CFTC regulation.<sup>2</sup> On February 23, 2012, the CFTC adopted final rules (the "Final Rules") that, among other things, set forth the requirements for the appointment of a CCO by the Registrant and the duties of an appointed CCO, including the preparation and delivery of the Annual Report.<sup>3</sup>

On April 13, 2016, in consultation with CFTC, the Securities and Exchange Commission (the "SEC") adopted a substantially similar set of rules (the "SEC Rules") governing CCO duties and annual report requirements for security-based swap dealers and major security-based swap participants.<sup>4</sup> Although the SEC Rules generally harmonize with the Final Rules, the SEC Rules occasionally depart from the language of the Final Rules in order to clarify requirements or address commenter concerns. In its proposed amendments, the CFTC takes the view that many of the SEC's changes are in fact beneficial to market participants and regulatory oversight and should be reflected in the CFTC Rules.

As a result, a number of the proposed amendments are conforming changes to the SEC Rules. Other changes are intended to further the CFTC's goals while reducing the regulatory burden on Registrants, and more clearly reflecting the CFTC's intent and experience, with respect to the duties of CCOs.

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## II. DEFINITION OF "SENIOR OFFICER"

In order to promote CCO independence, the CEA and CFTC Regulations require the CCO to report to, and in some cases consult with, the board of directors or senior officer of the Registrant. However, the CFTC elected not to define "senior officer" in the Final Rules. Registrants thus have some flexibility in structuring their reporting lines. For example, the CCO may report to the senior officer of a division of a larger company (if that division is registered as an SD) instead of the chief executive officer of the larger company. Nevertheless, to clarify the reporting line requirement in CFTC Regulation 3.3(a)(1), the CFTC now proposes to amend CFTC Regulation 3.1 by defining "senior officer" as "the chief executive officer or other equivalent officer of a registrant." In the proposed amendments, the CFTC reiterates that the new definition still permits CCOs to report to the head of a division, but only if the division is registered as an SD pursuant to a limited swap dealer designation. Otherwise, the proposed amendments to the rules would require the CCO to report to the board of directors or the chief executive officer. The proposed definition of "senior officer" is also consistent with the SEC Rules.

### III. AMENDMENTS TO CHIEF COMPLIANCE OFFICER'S DUTIES

CFTC Regulation 3.3(d) requires, among other things, that the CCO:

- administer policies and procedures reasonably designed to ensure compliance with the CEA and CFTC Regulations;
- resolve conflicts of interest;
- take reasonable steps to ensure compliance with the CEA and CFTC Regulations applicable to each Registrant;
- establish procedures for the remediation of certain noncompliance issues; and
- establish procedures for the handling, management response, remediation, retesting and resolution of noncompliance issues.

The proposed amendments are intended to more accurately implement the CFTC's intent with respect to the scope of the duties above and further the goal of promoting the CCO's active engagement in compliance monitoring. The amendments also attempt to reduce regulatory burdens on CCOs that provide limited corresponding benefit to the Registrant or the CFTC.

#### A. ADMINISTRATION OF POLICIES AND PROCEDURES

CFTC Regulation 3.3(d)(1) requires the CCO to administer policies and procedures reasonably designed to ensure compliance with the CEA and CFTC Regulations. The proposed amendments clarify that this requirement is limited to those policies and procedures relating to the Registrant's business as an SD, MSP or FCM, and not *all* of the Registrant's business that is otherwise subject to the CEA or the CFTC Regulations.

#### B. RESOLUTION OF CONFLICTS OF INTEREST

CFTC Regulation 3.3(d)(2) requires the CCO, in consultation with the board of directors or senior officer, to resolve any conflicts of interest that may arise. The proposed amendments make it explicit that the CCO need only "take reasonable steps" to resolve conflicts of interest. The CFTC notes that routine conflicts of interest can be resolved in the normal course of business through the CCO's general administration of policies and procedures, and need not always involve the CCO's direct expertise or consultation with the board of directors or senior officer. The proposed modification is consistent with the SEC Rules.

#### C. ENSURING COMPLIANCE

CFTC Regulation 3.3(d)(3) currently requires that the CCO "take reasonable steps to ensure compliance" with the CEA and CFTC Regulations applicable to the Registrant's business as an SD, MSP or FCM. The CFTC notes that, in its experience implementing CFTC Regulation 3.3(d)(3), CCOs expressed concern about the uncertainty as to the breadth of their required authority under the rule. The proposed

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amendment, which matches the corresponding language in the SEC Rules, clarifies that “reasonable steps” include establishing, maintaining and reviewing written policies and procedures (“WPPs”) reasonably designed to achieve compliance. It remains unclear, however, whether establishing, maintaining and reviewing WPPs would satisfy the requirement to take reasonable steps to ensure compliance.

### D. REMEDIATION OF NONCOMPLIANCE ISSUES

CFTC Regulations 3.3(d)(4) and 3.3(d)(5) require CCOs to consult with the board of directors or senior officer to establish procedures for the remediation of noncompliance issues. CFTC Regulation 3.3(d)(4) currently specifies several means of identifying noncompliance issues: compliance office review, lookback, internal or external audit finding, self-reported error and validated complaint. The proposed amendments modify these provisions in three ways. First, they remove the consultation requirement from both paragraphs. The CFTC notes that the requirement is “superfluous,” suggesting that consultation may still be appropriate or required by the remaining language in CFTC Regulations 3.3(d)(4) and 3.3(d)(5). Second, the CFTC proposes to expand CFTC Regulation 3.3(d)(4) to include the identification of noncompliance issues “through any means,” including the methods already specified. This change is consistent with the SEC’s position in the adopting release of the SEC Rules. Third, the CFTC proposes to clarify that the procedures in CFTC Regulation 3.3(d)(5) must be “reasonably designed” for the handling, management response, remediation, retesting and resolution (changed from “closing” in the original text) of noncompliance issues.

The proposed amendments do not address to what extent, if any, CFTC Regulations 3.3(d)(4) and 3.3(d)(5) would overlap if the amendments become effective. The original text of CFTC Regulation 3.3(d)(4) emphasized procedures for remediating those noncompliance issues identified by the specific means listed in the rule, with CFTC Regulation 3.3(d)(5) requiring procedures for handling noncompliance issues more generally. The addition of “any means” to CFTC Regulation 3.3(d)(4), however, suggests that the two paragraphs could be interpreted to impose similar responsibilities.

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## IV. AMENDMENTS TO ANNUAL REPORT REQUIREMENTS

CFTC Regulations 3.3(e) and 3.3(f) prescribe the contents and delivery of the Annual Report, which must contain, at a minimum:

- a description of the WPPs, including the code of ethics and conflicts of interest policies, of the Registrant;
- an identification and assessment (including a discussion of potential areas of improvement) of the WPPs reasonably designed to ensure compliance with each applicable requirement under the CEA and CFTC Regulations;
- a discussion of any material changes to the compliance program of the Registrant;

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- a description of the resources set aside for compliance with the CEA and CFTC Regulations and any material deficiency in such resources; and
- a description of any material noncompliance issues identified and the corresponding remediating actions.

The Annual Report requirement is intended to promote compliance behavior through periodic self-evaluation and inform the CFTC of possible compliance weaknesses. In its proposed amendments to the content and delivery requirements of the Annual Report, the CFTC states that its changes will more effectively further these goals while further reducing regulatory burdens on Registrants.

### A. DISCUSSION OF WRITTEN POLICIES AND PROCEDURES

CFTC Regulations 3.3(e)(1) and 3.3(e)(2) require that the Annual Report contain a description of the WPPs, including the code of ethics and conflicts of interest policies, of the SD, MSP or FCM, as applicable. The proposed amendments clarify which WPPs must be described by including a reference to CFTC Regulation 3.3(d) in CFTC Regulation 3.3(e)(1).

The CFTC also proposes a more efficient presentation of the Registrant's WPPs. Currently, CFTC Regulation 3.3(e)(2) requires that the Annual Report identify and assess the Registrant's policies and procedures as they relate to "each applicable requirement" of the CEA and CFTC Regulations. The CFTC notes that this requirement, in addition to burdening Registrants, resulted in rote, "check-the-box" disclosure containing "limited substantive discussion" regarding areas of improvement and recommended changes. Accordingly, the proposed amendments would allow Registrants to provide summaries of their WPPs, coupled with a detailed discussion of their annual assessment and recommended improvements.

### B. DISCUSSION OF RESOURCES ALLOCATED TO COMPLIANCE

Under CFTC Regulation 3.3(e)(4), the Annual Report is required to contain a description of the financial, managerial, operational and staffing resources set aside for compliance with the CEA and CFTC Regulations. In response to questions from Registrants, the proposed amendments clarify that this discussion is limited to those resources specifically allocated to the Registrant's activities as an SD, MSP or FCM, as applicable. This change harmonizes with the CFTC's proposed amendment to CFTC Regulation 3.3(d)(1) and the SEC Rules, and should also help dual Registrants more efficiently complete the required disclosure.

### C. DELIVERY REQUIREMENT

CFTC Regulation 3.3(f)(1) requires that the CCO deliver the Annual Report to the board of directors or senior officer of the Registrant prior to furnishing it to the Commission. The proposed amendments modify this process by requiring that the CCO deliver the Annual Report to the Registrant's audit committee (or equivalent body), board of directors *and* senior officer prior to furnishing it to the Commission. The CFTC's rationale, echoing the SEC's reasoning in the adopting release of the SEC Rules, is that all

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groups with overall responsibility for governance and internal controls should remain informed about the Registrant's compliance program.

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### V. REQUEST FOR COMMENT

The CFTC has requested comment on several aspects of the proposed amendments, including:

- whether the proposed definition of “senior officer” should be revised;
- whether the proposed revisions to the CCO duties are appropriate;
- the extent to which the revised CCO duties would create efficiencies or reduce or add burdens for Registrants;
- whether the proposed amendments to the Annual Report's content requirements are appropriate;
- what, if any, transition or ongoing costs or savings would result from the proposed changes to the Annual Report; and
- whether the proposed submission requirements for the Annual Report would cause undue burden.

Comments on the proposed amendments are due on or before Friday, July 7, 2017.

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### ENDNOTES

<sup>1</sup> See CFTC, “Chief Compliance Officer Duties and Annual Report Requirements for Futures Commission Merchants, Swap Dealers, and Major Swap Participants; Amendments,” 82 Fed. Reg. 21330 (May 8, 2017).

<sup>2</sup> See 7 U.S.C.A. § 6s(k)(1)-(3).

<sup>3</sup> See CFTC, “Swap Dealer and Major Swap Participant Recordkeeping, Reporting, and Duties Rules; Futures Commission Merchant and Introducing Broker Conflicts of Interest Rules; and Chief Compliance Officer Rules for Swap Dealers, Major Swap Participants, and Futures Commission Merchants”, 77 Fed. Reg. 20128 (Apr. 3, 2012). For more information on the Final Rules, please see our memorandum to clients entitled “CFTC Adopts Final Rules on Swap Dealer Major Swap Participant Recordkeeping and Reporting, Duties, and Conflicts of Interest Policies and Procedures; Futures Commission Merchant and Introducing Broker Conflicts of Interest Policies and Procedures; Swap Dealer, Major Swap Participant and Futures Commission Merchant Chief Compliance Officer,” dated March 8, 2012, available at [https://www.sullcrom.com/siteFiles/Publications/SC\\_Publication\\_CFTC\\_Adopts\\_Internal\\_Business\\_Conduct\\_Rules.pdf](https://www.sullcrom.com/siteFiles/Publications/SC_Publication_CFTC_Adopts_Internal_Business_Conduct_Rules.pdf).

<sup>4</sup> See “Business Conduct Standards for Security-Based Swap Dealers and Major Security-Based Swap Participants”, 81 Fed. Reg. 29959 (May 13, 2016).

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