

CFTC Staff Issues Guidance Regarding Annual Chief Compliance Officer Reports

December 18, 2019

The CFTC’s Division of Swap Dealer and Intermediary Oversight (“**DSIO**”) issued an advisory on December 4, 2019 to provide further guidance regarding the preparation and submission of chief compliance officer (“**CCO**”) annual compliance reports (“**CCO Annual Reports**”) for swap dealers (“**SDs**”), futures commission merchants (“**FCMs**”) and major swap participants (“**MSPs**”) (collectively, “**Registrants**”) pursuant to § 3.3 of the Commodity Exchange Act (“**CEA**”).¹ The CFTC **last modified the regulations and published guidance** related to CCO Annual Reports in 2018, and DSIO staff conducted an extensive review of the CCO Annual Reports for 2018, most of which were submitted after the effective date of the new requirements. The advisory reflects the staff’s views on several areas of the CCO Annual Report in which they noted deficiencies in the reporting, including: (1) areas for improvement; (2) financial, managerial, operational and staffing resources; (3) material non-compliance issues; (4) furnishing the annual report and related matters; (5) the certification requirement; (6) the Volcker Rule; and (7) other miscellaneous items. The table below summarizes the advisory’s guidance as compared to the relevant requirements and guidance in CFTC Rule 3.3 and Appendix C to Part 3.

CFTC Rule / Appendix C Guidance	New DSIO Guidance
<p>Rule 3.3(e)(2) – Assess the effectiveness of policies and procedures relating to the Registrant’s business as an FCM, SD or MSP.</p>	<p>The assessment of the effectiveness of a Registrant’s policies and procedures should be separate from the discussion of the areas for improvement. Many 2018 CCO Annual Reports included a discussion of the areas for improvement within the section of the report addressing the CCO’s assessment of the effectiveness of the Registrant’s policies and procedures under § 3.3(e)(2).</p>
<p>Rule 3.3(e)(3) – Discuss areas for improvement, and recommend potential or prospective changes or improvements to compliance program and resources devoted to compliance.</p>	<p>As noted above, the discussion of the areas for improvement should be a stand-alone section, distinct from an assessment of the effectiveness of the Registrant’s policies and procedures.</p> <p>The requirement to identify and assess areas for improvement in § 3.3(e)(3) is not limited to identifying policies and procedures that are ineffective, but rather requires a full discussion of the issues the CCO has identified to help facilitate compliance.</p> <p>DSIO staff believes that requiring a stand-alone section</p>

¹ U.S. Commodity Futures Trading Commission, Release No. 890-19, *DSIO Issues Advisory Providing Guidance and Staff Recommendations for Chief Compliance Officer Annual Report Preparation*, Dec. 4, 2019, <https://www.cftc.gov/PressRoom/PressReleases/8090-19>.

CFTC Rule / Appendix C Guidance	New DSIO Guidance
<p>Appendix C, Section C.1 – § 3.3(e)(3) requires two components in the CCO Annual Report: an identification and discussion of each area that needs improvement; and a discussion of what changes are recommended to address each area needing improvement.</p> <p>In addressing these two elements, the CCO Annual Report should include, as applicable: A discussion of why the particular area needs improvement; a discussion of the proposed improvements and the time frame for their implementation; and a cross-reference to the regulation that a recommended change would address.</p>	<p>will encourage fuller discussion of the potential or prospective changes, including any changes to resource allocations.</p> <p>CCO Annual Reports should include additional context concerning areas for improvement in order to satisfy the requirements of § 3.3(e)(3), such as why the improvement was necessary, the current status of the area for improvement, and whether remediation is ongoing or completed.</p> <p>Each identified area for improvement should also cite the CFTC regulation associated with the area for improvement.</p> <p>DSIO staff also recommends as a best practice that any reporting issues that do not rise to the level of material non-compliance should be reported as areas for improvement. Registrants <i>should not</i> create separate categories or additional sections, such as “areas for continued focus and diligence” or “other compliance challenges,” as was the case in some 2018 CCO Annual Reports.</p>
<p>Rule 3.3(e)(4) – Describe the financial, managerial, operational and staffing resources set aside for compliance with respect to the CEA and CFTC regulations, including any material deficiencies in such resources.</p> <p>Appendix C, Section D.1 – The description should include the following types of information: the budget allocated to the compliance department of the Registrant for compliance with the CEA and Commission regulations; full-time compliance staffing levels for such compliance activities; partially allocated staff counts (if applicable), with information on how much of such employees’ time is devoted to the Registrant’s compliance matters that are subject to CFTC oversight; an explanation of managerial resources (the explanation should clearly identify the division between staffing resources and management resources devoted to compliance); general infrastructure information (e.g., computers, compliance-oriented software, technology infrastructure, etc.); and if applicable, a description of the use of third party vendors or outsourcing for compliance activities.</p>	<p>DSIO staff interprets this rule to require specific reporting at the Registrant level and not at the parent or consolidated level. Firms with multiple Registrants must provide budget and staffing information for each entity.</p> <p>Registrants also must disaggregate resources devoted to compliance with legal or regulatory requirements that are unrelated to the costs of complying with the CEA and applicable CFTC regulations, to the extent such compliance costs are included in the CCO Annual Report. This level of detail will undoubtedly pose very challenging issues for Registrants, although the DSIO staff acknowledges that precise numerical budget and staffing information may not be available, and in such instances a Registrant should provide an estimate of the portion of the aggregated numerical information dedicated to compliance with CFTC regulation along with a rationale for the provided estimate.²</p> <p>When describing general infrastructure information as required by Appendix C, Registrants are encouraged to include a discussion of compliance-oriented software that describes (and names) the software used, how the software is used by personnel and how the software fits</p>

² DSIO emphasized that Registrants may use different methods to conduct such an estimate depending on their circumstances.

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<p>Appendix C, Section D. 2 – For those instances where compliance resources are shared, it is recognized that the description of the shared resources may reasonably be more general in nature, providing approximations and estimates based on expected needs.</p>	<p>into the Registrant’s overall regulatory compliance program.</p>
<p>Rule 3.3(e)(5) – Describe any material noncompliance issues identified, and the corresponding action taken.</p>	<p>Material non-compliance issues must not be limited to issues identified by an external entity such as an SRO, but rather must include issues identified from the Registrant’s own self-evaluations.</p> <p>DSIO staff also notes that while it may be the case that a Registrant simply does not identify any non-compliance issues that it deems to be material, “multiple or consecutive CCO Annual Reports that only discuss material non-compliance issues that were identified by external entities may indicate an improper standard of materiality, insufficient self-evaluation, or lack of proper CCO engagement.”</p>
<p>Appendix C, Section E – The CCO Annual Report should include an explanation of the standard the Registrant used to determine a non-compliance event’s materiality.</p>	<p>The CCO Annual Report must include a discussion of the standard that the Registrant used to determine whether a non-compliance issue was deemed to be material. This discussion should be included in the CCO Annual Report’s discussion of material non-compliance issues under § 3.3(e)(5).</p>
<p>Rule 3.3(e)(6) – List any material changes to compliance policies and procedures during the coverage period for the CCO Report.</p> <p>Appendix C, Section F – When describing any material changes to the WPPs, a description of the standard of materiality used should be provided. This description will provide meaningful context for any reported changes to the WPPs.</p>	<p>As opposed to providing a list of changes made to compliance policies and procedures, a Registrant should make an effort to identify <i>material</i> changes using the same standard of materiality as discussed by the Registrant elsewhere in its CCO Annual Report.</p>
<p>Rule 3.3(f)(1)(ii) – If the FCM, SD or MSP has established an audit committee (or an equivalent body), then the CCO shall furnish the annual report to the audit committee (or equivalent body) not later than its next scheduled meeting after the annual report is furnished to the Commission, but in no event more than 90 days after the applicable date for furnishing the annual report to the Commission.</p>	<p>DSIO staff notes that if the audit committee (or equivalent body) requirement is not applicable to the Registrant, then the Registrant should include a statement to that effect in the CCO Annual Report.</p>

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Rule 3.3(f)(3) – The report shall include a certification by the CCO or chief executive officer of the registrant 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 in all material respects.	DSIO staff advises that the certification statement language must exactly mirror the rule text and any variance would be a failure to satisfy the requirements of § 3.3(f)(3).
Rule 3.3(e) – The CCO Annual Report must cover the most recently completed fiscal year of the FCM, SD or MSP.	A Registrant should include the specific dates of coverage in the CCO Annual Report.

In addition to guidance with respect to specific requirements described above, DSIO staff confirms in the advisory that the compliance requirements of subpart D of the Volcker Rule must be included as part of the CCO duties and requirements under § 3.3. Thus, a discussion of the Volcker Rule regulations must be included among the suite of compliance obligations addressed in the CCO Annual Report.

Registrants will be expected to comply with the new advisory in their upcoming CCO Annual Reports. Any Registrant that files a CCO Annual Report that DSIO staff determines is not in compliance with §§ 3.3(e) and (f) may be required to file a corrected CCO Annual Report as required by § 3.3(f)(4).

If you have any questions regarding the matters covered in this publication, please contact any of the lawyers listed below or your regular Davis Polk contact.

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