July 7, 2017

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

Re: Chief Compliance Officer Duties and Annual Report Requirements for Futures Commission Merchants, Swap Dealers, and Major Swap Participants; Amendments; RIN 3038—AE56

Dear Mr. Kirkpatrick,

Better Markets Inc.[1] appreciates the opportunity to comment on the above-captioned proposed amendments ("Proposed Amendments" or "Proposals"), issued by the Commodity Futures Trading Commission ("CFTC" or "Commission").

The stated purpose of the Proposal is to reduce regulatory burdens, increase efficiencies, clarify the scope of Chief Compliance Officer ("CCO") duties, and better harmonize the CFTC's CCOs rules with those of the Securities and Exchange Commission ("SEC"). These goals may be appropriate under some circumstances, but they must never come at the expense of regulatory protections that are necessary to help maintain the stability and integrity of our financial markets, especially the swaps markets. In this case, while some of the Proposals appear to be positive or at least unobjectionable, a number of them weaken the CCO regime by reducing CCO accountability, marginalizing the Board of Director's ("Board") role in the compliance process, and removing valuable requirements that help ensure CCOs are engaged in meaningful compliance work. Those elements of the Proposal should be rejected or modified.

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[1] Better Markets is a non-profit, non-partisan, and independent organization founded in the wake of the 2008 financial crisis to promote the public interest in the financial markets, support the financial reform of Wall Street, and make our financial system work for all Americans again. Better Markets works with allies—including many in finance—to promote pro-market, pro-business, and pro-growth policies that help build a stronger, safer financial system, one that protects and promotes Americans' jobs, savings, retirements, and more.

INTRODUCTION AND BACKGROUND

CCOs can play an extremely valuable role in overseeing the activities of financial market participants. They have a unique perspective, as they act from within the institution. And, if they are properly empowered and insulated from corrupting influences, they can help prevent illegal conduct from occurring, limit its duration and scope, remediate any adverse impacts, and institute corrective measures to prevent recurrent violations.

In fact, effective CCOs are an indispensable private sector oversight mechanism, especially important in an age when regulators are badly underfunded and constantly pressured by many policy makers and industry interest groups to scale back their regulatory and enforcement activities. For these reasons, Better Markets has advocated consistently and strongly in support of an effective CCO regulatory framework.[2]

The Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act") reflects this important role for CCOs. The Dodd-Frank Act requires the designation of a CCO by each Swap Dealer ("SD") and Major Swap Participant ("MSP"[3]) and by each Future Commission Merchant ("FCM."[4]) The duties and responsibilities of CCOs designated by SDs and MSPs are specified in detail in the Dodd-Frank Act.[5] With regard to CCOs designated by FCMs, the Dodd-Frank Act simply imposes "such duties and responsibilities as shall be set forth in regulations to be adopted by the Commission . . . ." [6]

In general, these reforms require the designation of CCOs endowed with substantially more authority, independence, and access to the Board and senior management than in the past. This was part of the Dodd Frank Act's larger goal of fundamentally changing the regulatory approach to swaps market participants. For many years, market participants operated in an environment in which regulation was viewed as an obstacle to doing business. Changing this corporate culture so that firms embrace compliance as a sought-after goal requires a robust regulatory framework.

In 2012, the Commission adopted regulations 3.3(d) through (f) implementing the CCO provisions set forth in CEA sections 4d(d) and 4s(k).[7] The current Proposal would modify those rules with the following changes. The Proposal would:

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2 *See* Better Markets "Comment Letter on Establishing and Protecting a Meaningful Role for Chief Compliance Officers Under the Dodd-Frank Act Reforms" *available at* https://www.bettermarkets.com/sites/default/files/documents/SEC-%20Supp.%20CL-%20CCOs-%2010-18-13_0.pdf ; Better Markets "Comment Letter on Designation of a Chief Compliance Officer; Required Compliance Policies and Annual Report of a Futures Commission Merchant, Swap Dealer, or Major Swap Participant" *available at* https://www.bettermarkets.com/sites/default/files/documents/SEC-%20Supp.%20CL-%20CCOs-%2010-18-13_0.pdf.

3 7 U.S.C. § 6s (2012).

4 7 U.S.C. § 6d (2012).

5 7 U.S.C. § 6s (2012).

6 7 U.S.C. § 6d (2012).

7 17 CFR 3.3 § (d)–(f) (2016) ("CCO Rules"). *See* Swap Dealer and Major Swap Participant Recordkeeping, Reporting, and Duties Rules, 77 FR 20128 (Apr. 3, 2012).

- Define "Senior Officer" to be the "chief executive officer or other equivalent officer of a registrant;"

- Make clear that CCOs are responsible only for administering the policies and procedures that are related to their businesses as FCMs, SDs, or MSPs not all activities of those entities;

- Replace the CCO's obligation to resolve any conflicts that may arise in the firm with a requirement that the CCO take "reasonable steps" to resolve such conflicts;

- Clarify that the CCO's duty to take "reasonable steps" to ensure compliance includes the duty to ensure "that the registrant establishes, maintains and reviews written policies and procedures reasonably designed to achieve compliance;"

- Remove language requiring the CCO to consult with the Board or the Senior Officer when designing procedures to remediate noncompliance; add that policies and procedures be "reasonably designed" to achieve their goal; and clarify that CCOs must remediate any noncompliance issues identified "through any means;"

- Remove the requirement that the CCO's annual report include a review and assessment of the policies and procedures with respect to **each** regulatory requirement to which the firm is subject; and

- Require that the annual report be presented to both the Senior Officer **and** the Board, and to the audit committee as well.

SUMMARY OF COMMENTS

Better Markets believes that while some of the proposed changes are positive or neutral in impact, several cannot be justified and should be rejected. As a preliminary matter, we think the Proposal does not take sufficiently into account the CFTC's overarching duty to put the public interest above industry concerns.

On the substance of the Proposal, we support the measures that will strengthen the CCO framework by defining "Senior Officer" according to function, not just title; by requiring annual reports be given to both the Board and the Senior Officer; and by making clear that the duty to remediate compliance problems will apply to all concerns identified "through any means" by the CCO, not just the discovery methods listed in the current rule.

However, we oppose several of the proposals because they are likely to weaken the CCO framework:

- Replacing the CCO's duty to resolve conflicts of interest with a duty simply to take reasonable steps toward that goal;

- Potentially narrowing the scope of the CCO's compliance duty by specifying that it includes—and is perhaps limited to—establishing policies and procedures;

- Removing the Board consultation requirement in connection with remediating noncompliance issues and injecting a "reasonably designed" test into that process; and
- Eliminating the need to evaluate the policies and procedures specifically with respect to each regulatory requirement applicable to the entity.

Finally, we take this opportunity to urge the Commission to adopt additional measures that will strengthen the CCO's relationship with the Board. This comment essentially reiterates some of our past advocacy for a reform that will enhance the regulatory framework governing CCOs and promote their efficacy.

COMMENTS

I. The Proposal strays from the CFTC's overarching duty to put the public interest above concerns about regulatory costs and burdens, efficiencies, and regulatory harmony.

When considering whether to adopt regulations, the CFTC's duty is to act first and foremost in the public interest. Indeed, when considering the economic impact of its rules, its explicit and primary statutory obligation is to consider the "protection of market participants and the public."[8] And while the Dodd-Frank Act encourages the Commission to consult with the SEC,[9] the CFTC must still consider above all the public interest.

In the Release, the Commission states that it seeks to "increase efficiency, reduce regulatory burden, and clarify the scope of CCO duties," as well as harmonize its rules on CCOs with those of the Security Exchange Commission ("SEC.")[10] These goals may be appropriate under some circumstances. Reducing wholly unnecessary costs and burdens of regulation makes sense, but only if regulatory protections are fully preserved. Unfortunately, these goals are often code words for de-regulation. Rule amendments predicated on such objectives can sometimes mask efforts to significantly dilute substantive regulatory standards.

In some respects, the Proposal falls prey to this de-regulatory approach. As discussed below, some of the specific Proposed Amendments will undermine the CCO regulatory regime. More generally, the Release reveals an approach that subordinates the public interest to industry concerns about regulatory burdens and costs. In the "Request for Comment" portion of the Release, the six questions focus on efficiencies for registrants, the reduction of burdens and costs, and harmony with parallel SEC requirements.[11] Apart from

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8 *See* 7 U.S.C. § 19(2) (2012)

9 15 U.S.C. § 8302(a)(1)-(2) (2012).

10 Chief Compliance Officer Duties and Annual Report Requirements for Futures Commission Merchants, Swap Dealers, and Major Swap Participants; Amendments, 82 FR 21330, 21331 (proposed May 8, 2017) ("Release").

11 Release at 21333.

a general question regarding whether the proposed revisions are "appropriate," not one of the requests for comment seeks input on whether the proposed changes will undermine investor protection, market integrity, or the public interest more generally.

This is unacceptable. We call upon the Commission to ensure that all its regulations, including those intended to streamline or minimize regulatory burden, unerringly adhere to the agency's overarching duty to protect the public interest.

II. <u>While some of the proposed changes are positive or neutral in impact, several cannot be justified and should be rejected.</u>

Some of the Proposals are positive and will likely strengthen the regulation of CCOs or at least avoid undermining the current framework. For example, the Commission proposes to clarify the definition of "Senior Officer" to include "the chief executive officer or other equivalent officer of a registrant." This change will help preserve the CCO's direct reporting line to the person who is in fact, and not just in name, the most senior member of management. This in turn will help protect and preserve the independence of CCOs.

In addition, expanding the universe of corporate leadership who must receive the CCO's annual report to include both the Senior Officer **and** the Board, and in addition the audit committee, will help ensure that the CCO's findings and recommendations are brought to the attention of a wider swath of management. The report is therefore more likely to be taken seriously and acted upon.

Furthermore, the Proposal would make clear that the duty to remediate compliance problems will apply to all problems identified "through any means" by the CCO, not just the discovery methods listed in the current rule. This too will help broaden the scope of the CCO's compliance activities and obligations, removing an arbitrary limitation framed in terms of discovery methods that makes no sense.

We commend the Commission for these proposals. However, as detailed below, several amendments in the Proposal will in fact undermine the CCO regulatory framework, and we urge the Commission to abandon or modify them.

A. <u>Replacing the CCO's duty to resolve conflicts of interest with a duty simply to take reasonable steps toward that goal weakens the CCO regulatory framework.</u>

Current regulation 3.3(d)(2) affirmatively requires CCOs, in consultation with management, to resolve conflicts of interest. This mirrors the language of the CEA. However, the Proposal would only require CCOs to "take reasonable steps" to resolve such conflicts.

This change suffers from a number of flaws. First, it deviates from the applicable statutory language. The CEA clearly requires that CCOs actually resolve such conflicts, not merely attempt to do so or take steps in that direction. 7 U.S.C. § 6s(k)(2)(C). The Release suggests that this re-writing of the statute is only a matter of making explicit "an implicit

reasonableness standard."[12] But the Releases offers no support for this claim, which cannot justify a material regulatory departure from what the law says.

Second, this alteration will in fact dilute the CCO's obligation to address conflicts of interest. It creates the opportunity for CCOs to satisfy the requirement by "checking the box"—instituting certain measures designed to address conflicts without regard to whether they actually work.

Finally, the Commission's practical justification makes little sense. The Release argues that the current rule language requires CCOs to **personally** resolve each and every conflict of interest that arises in the firm, and that this places an undue burden and distraction on the CCO.[13] However, the remedy for this concern would be to require the CCO to resolve conflicts "directly or indirectly," not to weaken the obligation in a wholly unrelated way by allowing mere effort to suffice. In other words, the proposed change does not address **who** must resolve conflicts, but instead weakens the standard governing **how** that obligation is met. The Commission should abandon this change.

B. Clarifying the scope of the CCO's compliance duty in Section 3.3(d)(3) may also unduly narrow it.

Current regulation 3.3(d)(3) requires the CCO to take "reasonable steps to ensure compliance with the Dodd-Frank Act and Commission regulations" relating to the market participant's swaps activities. The Proposal would add that this duty would **include** "ensuring the registrant establishes, maintains, and reviews written policies and procedures reasonably designed to achieve compliance with the Act and regulations."

This amendment would appear to be innocuous, insofar as it simply adds one explicit way—establishing policies and procedures—in which the CCO must discharge its compliance obligation. But language in the Release indicates that the amendment may be viewed as defining the full scope of that duty, not merely clarifying it. The Release explains that in the four years since the original rule was adopted, "CCOs and their representatives have expressed concern about the uncertainty as to the breadth of their required authority under the rule."[14] It goes on to state that the Commission intends to address that uncertainty "by **specifically identifying the CCO's duties** with regard to compliance policies and procedures."[15]

As a threshold matter, we question whether a pattern of industry complaints, without more, is a sufficient basis for making a regulatory amendment. The Commission should require more concrete evidence showing that the rule as written creates an actual problem among market participants necessitating a rule change.

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12 Release at 21332.
13 Release at 21332.
14 *Id.* at 21333
15 *Id.* (emphasis added).

Turning to the substantive implications of the change, it should be apparent that the duty to ensure compliance with the law cannot be satisfied solely through the issuance of policies and procedures. The regulations already specify that the CCO has the duty to create and administer the registrant's policies and procedures,[16] and the broader duty to ensure compliance with the law cannot reasonably be equated with that obligation. It is simply not enough to require that CCOs essentially serve as stewards of the written policies and procedures. To eliminate any risk that the amendment could be so interpreted, the Commission should, at a minimum, add the proviso that the duty to ensure compliance includes, **without limitation,** the duty to establish policies and procedures.

C. Removing the Board consultation requirement and injecting a "reasonably designed" test into the requirements for remediating noncompliance issues will undermine the CCO framework.

The rules currently require the CCO to establish procedures, in consultation with the Board, for the remediation of noncompliance issues. The Proposal would remove the consultation requirement as "superfluous," and also "clarify" that the policies and procedures be "reasonably designed" to achieve the stated purpose.[17] These changes are unwise.

First, deleting the explicit requirement that the CCO consult with the Board may, in some situations, marginalize the Board's role in establishing procedures to remediate noncompliance issues. The Release in effect confirms the point by acknowledging that the CCO **should** consult:

> In removing the consultation requirement, the Commission acknowledges that in carrying out their duties, a CCO should manage and remediate compliance issues by consulting, as appropriate, with business lines, senior management, the board of directors, and independent review groups.[18]

If the mandatory consultation language in the current rule serves no purpose, it is difficult to see why the Commission considered it necessary to include this guidance establishing a clear expectation that CCOs will consult. In fact, the proposed change will create an avoidance mechanism where a clear-cut rule is needed most: where a CCO clearly should consult the Board on a material noncompliance issue but either chooses to evade that step or is pressured to do so by management. In addition, removing language requiring consultation with the Board sends the wrong signal by deemphasizing the strong relationship that CCOs must have with the Board. Only with that connection firmly in place can firms implement effective compliance programs. The message the Commission seems to be sending is that the Board need only be occasionally involved. These signals run directly counter to sound risk management and undermine efforts to enhance the effectiveness of CCOs.

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16 *See* 17 C.F.R 3.3(d)(1)-(5) (2016).
17 Release at 21333.
18 *Id* at 21333.

Second, the provision that the policies and procedures governing remediation of compliance problems shall be "reasonably designed" to achieve the stated purpose is a recurrent and unfortunate change that has a fundamentally de-regulatory character. As with the proposed amendment that would only require "reasonable steps" in the direction of compliance, *see* part II.A. above, such standards make it easier for a regulated person or entity to satisfy their legal obligations without actually achieving the regulatory goals those obligations serve. The policies and procedures should of course be designed to achieve compliance; but they should also be **required** to attain that result.

D. Narrowing the scope of the annual review of policies and procedures will needlessly weaken an important self-assessment process.

The rules currently require the CCO's annual report to include a description of the compliance policies and procedures, an assessment of their effectiveness, and a discussion of any areas of improvement and recommended changes.[19] These three components of the report must be included for **each** regulatory requirement to which the registrant is subject. The Proposal would eliminate the need to evaluate the policies and procedures specifically with respect to each regulatory requirement.

The Commission explains that the proposed change is based on industry feedback indicating that the amount of time and resources needed for this exercise is burdensome relative to the intrinsic value of that portion of the report, especially since written policies and procedures remain largely unchanged year to year.[20] Further, the Commission notes, many annual reports provide the required analysis in a rote manner, suggesting that the annual report requirement is encouraging a limited "check-the-box" appraisal rather than the intended active and ongoing self-evaluation.

We submit that the detailed assessment of the policies and procedures, relative to each specific regulatory requirement, is a valuable exercise that brings rigor to the process. Such a mandatory and exhaustive appraisal would tend to counteract rather than foster the type of "rote-like" approach cited in the Release. Matching each policy and procedure with each statute or regulation forces the CCO to think about any gaps in their compliance program. And if lackluster, mechanically-prepared reports are indeed a problem, then the solution is not to allow a more general and potentially even more mechanical self-assessment, but instead to insist that firms go back to the proverbial drawing board and conduct an analysis that satisfies the letter and spirit of the rule.

E. The Commission should consider improving the regulations surrounding CCOs through strengthening and clarifying the CCO's independence and its relationship with the board of directors.

The Commission cites as one of its goals in amending the CCO rules "to provide greater clarity regarding the CCO reporting line required by CEA."[21] To further advance this

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19 *Id.*

20 *Id.*

21 Release at 21331.

goal, and to actually strengthen the independence of the CCO, the Commission should pursue several additional, related reforms. These are measures that Better Markets has previously urged upon the Commission,[22] and in light of the Commission's current focus on the CCO regime, now is an appropriate time to take them up again. Specifically, the Commission should adopt the following provisions:

- The decision to designate or terminate a CCO (or to materially change the CCO's position or responsibilities) should be the sole responsibility of the independent members of the Board (or Audit Committee) acting by majority vote, and not the responsibility of any executive officer.

- While the day-to-day reporting responsibility of a CCO will inevitably be to an executive officer, the CCO must also have a direct reporting line to the independent directors, and the CCO should be required to meet with and report to the independent directors no less than once a quarter.

- Finally, the compensation of a CCO should be the sole responsibility of the independent members of the Board, and not the responsibility of a Senior Officer.

These changes will help ensure that the CCO can serve as a strong and independent force, insulated from inappropriate pressures, influences, or even threats that can neutralize a CCO's effectiveness.

CONCLUSION

We hope these comments are helpful in your consideration of the Proposed Amendments.

Sincerely,

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22 *See* Better Markets "Comment Letter on Designation of a Chief Compliance Officer; Required Compliance Policies and Annual Report of a Futures Commission Merchant, Swap Dealer, or Major Swap Participant" *available at* http://www.bettermarkets.com/sites/default/files/CFTC-%20Comment%20Letter-%20CCO%201-18-11.pdf at 4.

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